FILE COPY

No. 64

FILED
JUL 18 1969
JOHN F. DAVIS, CLERK

In the

Supreme Court of the United States

OCTOBER TERM, 1969.

ELMER E. MILLS AND LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF OF PETITIONERS ELMER E. MILLS AND LOUIS SUSMAN

ARNOLD I. SHURE
11 South LaSalle Street
Chicago, Illinois 60603

ROBERT A. SPRECHER
111 West Monroe Street
Chicago, Illinois 60603

EDWARD N. GADSBY
75 Federal Street
Boston, Massachusetts 02110

MOZART G. RATNER
818 — 18th Street, N.W.
Washington, D.C. 20006
Counsel for Petitioners

The Scheffer Press, Inc.—ANdover 3-6850

Opinions Be
Jurisdiction
Statutes and
Questions P
Statement o
Summary of
Argument ...
I. THE S
LIABI
VIOLA
WITH
CASE
II. BY E
DISCL
TOR R
JUDIC
EFFEC
PROCE
A. The
ance
Cour
B. The
Discl
Decep
C. The
an E
D. The
tween
the M

INDEX

PAGE

Below 1

on 2

and Rule Involved 2

Presented 4

t of the Case 4

of Argument 8

t 12

E SEVENTH CIRCUIT'S DENIAL OF ANY BILITY OR REMEDY FOR A MATERIAL LATION OF THE ACT CONFLICTS TH THIS COURT'S DECISION IN *J. I. E CO.* v. *BORAK* 12

EXPRESSLY COMPELLING PUBLIC CLOSURE PREDICATED UPON INVES- R RELIANCE, CONGRESS FORECLOSED DICIAL INQUIRY INTO THE ACTUAL FECT ON SHAREHOLDER MENTAL OCESSES 23

The Congressional Finding of Public Reliance Was Erroneously Disregarded by the Court Below 23

The Congressional Purpose of Compulsory Disclosure Excludes Consideration of Actual Deception 26

The Statutory Scheme Eliminates Reliance as an Element of the Civil Remedy 29

The Relevant Causal Relationship Is Between the Unlawful Proxy Solicitation and the Merger 33

PAGE

III. THE SEVENTH CIRCUIT'S RELIANCE-CAUSATION TEST REQUIRES UNWORKABLE SPECULATIVE INQUIRY INTO SHAREHOLDER MENTAL PROCESSES IN VIOLATION OF THE POLICY OF THE ACT .. 35

A. The Seventh Circuit's "But For" Test Is More Restrictive Than Common Law Requirements 37

B. Since Subjective Inquiry Into Stockholders' Mental Processes Is Impracticable, the Intended, Reasonable, and Probable Tendency of the Proxy Statement Controls 39

IV. A JUDICIAL RECONSTRUCTION OF THE STOCKHOLDERS' VOTES CANNOT BE PREDICATED ON THE FAIRNESS OF THE MERGER 44

A. The Seventh Circuit's Conclusive Presumption of Shareholder Approval If the Merger Were Fair Is Unfounded in Fact 45

B. The Decision Below Stultifies the Congressional Purpose by Disenfranchising the Stockholders and Substituting a Judicial Appraisal of the Merger's Merits for Their Actual and Informed Vote 48

C. The Seventh Circuit's Decision Renders the Act Superfluous by Making Liability Turn upon the Substantive Fairness of the Merger .. 51

D. The Seventh Circuit's Ruling Makes the Statutory Right More Restrictive Than Traditional Non-Statutory Restitution, Where Fairness Is No Defense 54

PAGE

V. THE DECISION BELOW STIFLES PRIVATE ENFORCEMENT SUITS, A NECESSARY SUPPLEMENT TO COMMISSION ACTION IN ENFORCING THE ACT, BY RAISING INSUPERABLE OBSTACLES TO RELIEF 56

VI. THE DECISION BELOW DEFEATS THE CONGRESSIONAL POLICY BY BARRING ANY RELIEF ONCE A MERGER, LATER FOUND TO BE FAIR, IS CONSUMMATED 61

A. Rescission by Dissolution Is an Available Remedy for a Consummated Merger 63

B. The Remedy of Monetary Restitution Is Available to Redress a Consummated Merger Authorized Pursuant to Unlawful Proxy Solicitation 65

CONCLUSION 70

CITATIONS

Cases

Allis-Chalmers Manufacturing Company v. *NLRB*, 261 F.2d 613 (7th Cir. 1959) 34

American United Mutual Life Insurance Company v. *Avon Park*, 311 U.S. 138 (1940) 42

Bakery and Confectionery Workers International Union of America v. *Ratner*, 335 F.2d 691 (D.C. Cir. 1964) 62

Barnett v. *Anaconda Company*, 238 F. Supp. 766 (S.D. N.Y. 1965) 39

Bell v. *Southwell*, 376 F.2d 659 (5th Cir. 1967) 49, 50

Bynum v. *Baggett Transportation Company*, 228 F.2d 566 (5th Cir. 1966) 62

PAGE

Celanese Corporation of America v. *NLRB*, 279 F.2d 204 (7th Cir. 1960), *vacated for re onsideration*, 365 U.S. 297 (1961), *on remand*, 291 F.2d 224 (7th Cir. 1961), *cert. denied* 368 U.S. 925 (1961) 34

Colonial Realty Corporation v. *Bache & Co.*, 358 F.2d 178 (2d Cir. 1966), *cert. denied*, 385 U.S. 817 (1966) .. 26

Commonwealth Coatings Corp. v. *Continental Casualty Co.*, 393 U.S. 145 (1968) 43, 65

Dann v. *Studebaker-Packard Corporation*, 288 F.2d 201 (6th Cir. 1961) 52, 57, 62

DeMarco v. *Edens*, 390 F.2d 836 (2d Cir. 1968) 31

Deckert v. *Independence Shares Corp.*, 311 U.S. 282 (1940) 32, 66

DeMarco v. *Edens*, 390 F.2d 836 (2d Cir. 1968) 31

Dow v. *Humbert*, 91 U.S. 294 (1876) 62

Eagle v. *Horvath*, 241 F. Supp. 341 (S.D.N.Y. 1965) .. 44

Eastside Church of Christ v. *National Plan, Inc.*, 391 F.2d 357 (5th Cir. 1968), *cert. denied*, 393 U.S. 913 (1968) 21, 64

Falk v. *Hoffman*, 233 N.Y. 199, 135 N.E. 243 (1922) 55

First National Bank v. *Cities Service*, 391 U.S. 253 (1968) 47

Gerstle v. *Gamble-Skogmo, Inc.*, C.C.H. Fed. Sec. L. Rep. ¶92,367 (E.D.N.Y. March 7, 1969) 55, 69

Globus, Inc. v. *Jaroff*, 271 F. Supp. 378 (S.D.N.Y. 1967) 38

Goldstein v. *Groesbeck*, 142 F.2d 422 (2d Cir. 1944) 65

Hanover Shoe Co. v. *United Shoe Machinery Corp.*, 392 U.S. 481 (1968) 60

Janigan v. *Taylor*, 344 F.2d 781 (1st Cir. 1965), *cert. denied* 382 U.S. 879 (1965) 55

PAGE

J. I. Case Co. v. *Borak*, 377 U.S. 426 (1964) 8, 9, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 32, 33, 35, 40, 48, 50, 51, 52, 56, 57, 59, 60, 61, 62, 63, 64, 66, 69

Kardon v. *National Gypsum Co.*, 73 F. Supp. 798, *modified* 83 F. Supp. 613 (E.D. Pa. 1947) 55

Katzenbach v. *McClung*, 379 U.S. 294 (1964) 43

King v. *Lamborn*, 186 Fed. 21 (9th Cir. 1911) 54

Klopot v. *Northrup*, 131 Conn. 14, 37 A.2d 700 (1944) .. 39

Laurenzano v. *Einbender*, 264 F. Supp. 356 (E.D.N.Y. 1966) 17, 39, 49, 53

List v. *Fashion Park, Inc.*, 340 F.2d 457 (2d Cir. 1965) .. 30

Longwith v. *Butler*, 8 Ill. 32 (1845) 37

Mader v. *Armel*, 402 F.2d 158 (6th Cir. 1968), *cert. denied* 394 U.S. 930 (1969) 42

Mather v. *Barnes*, 146 Fed. 1000 (W.D. Pa. 1906) 54

Mills v. *The Electric Autolite Company*,
403 F.2d 429 (1968) 1, 5, 6, 7, 8, 13, 15, 16, 17, 18, 20, 22, 23, 26, 33, 34, 35, 37, 38, 39, 44, 45, 47, 56, 57, 60, 61
281 F. Supp. 826 (N.D.Ill. 1967) 1

Montgomery v. *Bucyrus Machine Works*, 92 U.S. 257 (1875) 68

Mosser v. *Darrow*, 341 U.S. 267 (1951) 65

Myzel v. *Fields*, 386 F.2d 718 (8th Cir. 1967) 30

National Bank & Loan Co. v. *Carr*, 189 U.S. 426 (1903) 66, 69

National Bank & Loan Co. v. *Petrie*, 189 U.S. 423 (1903) 66, 68

NLRB v. *Burnup & Sims*, 379 U.S. 21 (1964) 25

NLRB v. *Donnelly Garment Co.*, 330 U.S. 219 (1947) 41

NLRB v. *Illinois Tool Works*, 153 F.2d 811 (1946) 25

PAGE

Peterson v. *Greenville*, 373 U.S. 244 (1963) 38

Republic Aviation Corp. v. *NLRB*, 324 U.S. 793 (1945) .. 41

Rogers v. *Guaranty Trust Company*, 288 U.S. 123 (1933) 25, 42

Sankin v. *5410 Connecticut Avenue Corporation*, 281 F. Supp. 524 (D.D.C. 1968) 62

Schine Chain Theatres, Inc. v. *United States*, 334 U.S. 110 (1948) 64

SEC v. *Capital Gains Research Bureau, Inc.*
375 U.S. 180 (1963) 15, 26, 27, 28, 36, 37, 53
306 F.2d 606 (1962) 53

SEC v. *Great American Industries, Inc.*, 407 F.2d 453 (2d Cir. 1968), *cert. denied*, 89 S.Ct. 1770 (May 26, 1969) 62

SEC v. *National Securities, Inc.*, 393 U.S. 453 (1969) ....
.....11, 15, 19, 20, 32, 52, 53, 59, 60, 62, 63, 64, 65

SEC v. *Okin* 139 F.2d 87 (2d Cir. 1943) 62

SEC v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom. Coates* v. *SEC* and *Kline* v. *SEC*, 89 S. Ct. 1454 (April 21, 1969) 36, 59

Silver v. *New York Stock Exchange*, 373 U.S. 341 (1963) 47

Sprague v. *Ticonic National Bank*, 307 U.S. 161 (1939) .. 62

Sterling v. *Mayflower Hotel Corp.*, 33 Del. Ch. 20, 89 A.2d 862 (1952), *affirmed* 33 Del. Ch. 293, 93 A.2d 107 (1952) 66

Stern v. *Kirby Lumber Co.*, 134 Fed. 509 (S.D.N.Y. 1904) 54

Subin v. *Goldsmith*, 224 F.2d 753, 767 (2d Cir. 1955) (dissenting opinion) 27

Surowitz v. *Hilton Hotels Corporation*, 383 U.S. 363 (1966) 56

PAGE

Tcherepnin v. *Knight*, 389 U.S. 332 (1967) 56

The Fair v. *Kohler Die & Specialty Company*, 228 U.S. 22 (1913) 63

Truston v. *Nashville & American Trust Co.*, 32 F. Supp. 929 (M.D. Tenn. 1940) 54

Union Pacific R. Co. v. *Chicago and North Western Ry. Co.*, 226 F. Supp. 400 (N.D. Ill. 1964) 40

United States v. *Mississippi Valley Generating Co.*, 364 U.S. 520 (1961) 65

United States v. *Mock*, 149 U.S. 273 (1893) 62

United States v. *United Shoe Machinery Corporation*, 391 U.S. 244 (1968) 64, 65

Voege v. *American Sumatra Tobacco Corporation*, 241 F. Supp. 369 (D.Del. 1965) 30

Wirtz v. *Hotel, Motel and Club Employees Union*, 391 U.S. 492 (1968) 46, 47

Wolf v. *Weinstein*, 372 U.S. 633 (1963) 48, 51, 65

Woodward v. *Wright*, 266 F.2d 108 (10th Cir. 1959) .. 31

Zenith Radio Corporation v. *Hazeltine Research, Inc.*, 89 S.Ct. 1562 (May 19, 1969) 64

STATUTES AND RULES

Fed. Rules Civ. Proc., Rule 56, 28 U.S.C.A.:

Rule 56(c) 6, 61

Rule 56(d) 61

Rule 56(e) 47

Fed. Rules Civ. Proc. Rule 12(b)(6), 28 U.S.C.A. 14

Judicial Code and Judiciary, 28 U.S.C.A.

§1292(b) 61

§1254(1) 2

PAGE

Rule under the Securities Exchange Act of 1934:
Rule 14a-9, 17 C.F.R. 240.14a-9 .....3, 23

Securities Exchange Act of 1934, 15 U.S.C. §§78a, *et seq.*: 2, 20, 22, 29
Section 10(b), 15 U.S.C. §78j 30, 55, 59
Section 14(a), 15 U.S.C. §78n(a) 2, 4, 5, 6, 9, 11, 13, 14, 15, 16, 21, 23, 25, 26, 32, 33, 35, 43, 48, 50, 51, 55, 56, 58
Section 18(a), 15 U.S.C. §78r 30
Section 27, 15 U.S.C. §78aa 14, 15, 33, 66
Section 29(b), 15 U.S.C. §78cc(b) 3, 21, 63, 65, 66

Securities Act of 1933, 15 U.S.C. §§77a, *et seq* : 29
Section 5, 15 U.S.C. §77e 24, 32
Section 11, 15 U.S.C. §77k 29
Section 12, 15 U.S.C. §77*l* 30, 31, 32
Section 17, 15 U.S.C. §77q 30

MISCELLANEOUS

Advisory Committee Note, 31 F.R.D. 648 (1962) 47

ARANOW AND EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL (2d ed. 1968) 40

BOK, *The Regulation of Campaign Tactics in Representation Elections Under the National Labor Relations Act*, 78 HARV. L. REV. 38 (1964) 40, 41

BRANDEIS, OTHER PEOPLE'S MONEY (NHLF ed. (1914)) 27

Brief of Petitioners Harry G. Barr *et al., J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) 51

CAMPBELL, CONVERSE, MILLER & STOKES, THE AMERICAN VOTER (1960) 40

DISCLOSURE TO INVESTORS, REPORT AND RECOMMENDATIONS TO THE SECURITIES AND EXCHANGE COMMISSION FROM THE DISCLOSURE POLICY STUDY, "THE WHEAT REPORT", (March 27, 1969) 24, 27, 28, 29, 32, 53

PAGE

DOUGLAS, *Protecting the Investor*, 23 YALE REV. (N.S.) 508 (1933) 28

HORNSTEIN, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658 (1956) 62

H.R. REP. No. 85, 73d Cong., 1st Sess. (1933) 31

H.R. REP. No. 1383, 73d Cong., 2d Sess. (1934) 21, 56

JENNINGS AND MARSH, SECURITIES REGULATION: CASES AND MATERIALS (2d ed. 1968) 41

LOSS, *Private Actions Under the Proxy Rules*, 73 HARV. L. REV. 1041 (1961) 42

LOSS, SECURITIES REGULATIONS (1st ed. 1951) 31

LOSS, SECURITIES REGULATION (2d ed. 1969 Supp.) 42

RESTATEMENT, RESTITUTION (1936) 38, 67

RESTATEMENT (SECOND) TRUSTS (1959) 54

SHULMAN, *Civil Liability and the Securities Act*, 43 YALE L.J. 227 (1933) 26

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969.

No. 64

ELMER E. MILLS AND LOUIS SUSMAN,
Petitioners,

vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY and AMERICAN MANUFACTURING COMPANY, INC.,
Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

---

BRIEF OF PETITIONERS ELMER E. MILLS AND LOUIS SUSMAN

OPINIONS BELOW

The November 25, 1968, opinion of the Court of Appeals for the Seventh Circuit is reported at 403 F.2d 429 (A.1001); its Order is set forth in the Appendix, page 1015. The September 26, 1967, opinion of the District Court for the Northern District of Illinois is reported at 281 F. Supp. 826 (A.675); the District Court's unreported September 26, 1967, Findings of Fact appearing

without substantial controversy and Conclusions of Law on which summary judgment was granted are set forth in the Appendix, pages 684 and 689, respectively, and its unreported September 26, 1967, Order granting Motion for Summary Judgment is set forth in the Appendix, page 690. The District Court's unreported November 15, 1965, Memorandum Opinion granting Summary Judgment as to Count II of the Amended and Supplemental Complaint is set forth in the Appendix, page 441.

JURISDICTION

The order of the Court of Appeals for the Seventh Circuit sought to be reviewed was entered on November 25, 1968. The Petition for Certiorari was granted on April 21, 1969. This Court has jurisdiction under 62 Stat. 928, 28 U.S.C. 1254(1). The case arises under the provisions of the Securities Exchange Act of 1934, as amended, 48 Stat. 881, 15 U.S.C. §78a, *et seq.*

THE STATUTES AND RULE INVOLVED

Section 14(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 48 Stat. 895,[1] provides:

[1] This section was amended August 20, 1964, 78 Stat. 569, after this action was commenced, but no changes were made which are of consequence to this action. As amended, Section 14(a) provides:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 12 of this title.

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 14a-9(a) promulgated by the Securities and Exchange Commission pursuant to Section 14(a) of the 1934 Act, 17 C.F.R. 240.14a-9(a) provides:

> No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

Section 29(b) of the 1934 Act, 48 Stat. 903, provides:

> Every contract made in violation of any provision of this title or of any rule or regulation . . . shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract . . . .

QUESTIONS PRESENTED

1. Whether minority stockholders are denied any federal remedy for material misrepresentations in a proxy statement, violative of Section 14(a) of the 1934 Act, soliciting necessary votes for a merger, if the court can be satisfied that the merger terms are fair by common law standards.

2. Whether liability for material misrepresentation in a merger proxy statement violating Section 14(a) of the 1934 Act depends upon a factual finding that a critical number of votes were changed by the particular omission or misrepresentation.

3. Whether a factual finding, if relevant, that a critical number of votes were not changed by the particular omission or misrepresentation in a merger proxy statement, excusing its violation of Section 14(a) of the 1934 Act, may be predicated upon fairness of the financial terms of merger.

4. Whether all relief for material misrepresentation in a proxy statement for a merger enjoinable under Section 14(a) of the 1934 Act is barred by consummation of the merger if the court can be satisfied that the merger terms are fair by common law standards.

STATEMENT OF THE CASE

Petitioners were shareholders of The Electric Auto-Lite Company ("Auto-Lite") until 1963, when it was purportedly acquired by and merged into Mergenthaler Linotype Company ("Mergenthaler"), which thereupon was renamed Eltra Corporation. Under the merger terms Auto-Lite stock already owned by Mergenthaler was to be retired, and thus "[i]n a real sense, the merger was a

bargain between Mergenthaler and the minority shareholders in Autolite." A.1009. "In substance, Mergenthaler was offering that . . . all minority common stock interests in Autolite would be transformed into preferred stock interests" (A.1005) in the resulting new conglomerate. The proxy statement was "in form, addressed to all shareholders, [but] was, in realistic terms, intended for the minority shareholders." A.1005. In it, the value of the minority shareholders' equity in Auto-Lite was acknowledged to be $46.7 million, while the value of the preferred stock they were to receive in return was fixed at $34.4 million, the differential of $12.3 million being assigned as capital surplus accruing to the Mergenthaler shareholders' equity as a result of the merger. A.39.

The proxy statement did *not* reveal that its ostensible authors, the Auto-Lite Directors, were all nominees of Mergenthaler, selected and deputed to serve "the best interests of Mergenthaler". A.1009. This was established by respondents themselves in proceedings under the Investment Company Act (A.237) resulting in an adjudication by the SEC in respondents' favor two months earlier. A.418. In their proxy statement, however, "[t]he Autolite board, selected by their adversary, presumed to advise the minority shareholders to approve the merger" (A.1009) and "implied that the board was giving disinterested advice." A.1010. They printed their recommendation in large bold face type (A.1006) on the second page of the complex 108 page document. A.30.

Suing for the shareholders of Auto-Lite as a class and derivatively on behalf of Auto-Lite, petitioners alleged that the proxy statement used to solicit votes in favor of the merger was materially misleading in violation of Section 14(a) of the 1934 Act and Rule 14a-9 thereunder.

Their complaint alleged that because votes essential to authorization of the merger were obtained through use of the unlawful proxy statement, the merger was void. They prayed that the merger be set aside, that the assets of Auto-Lite be returned to it, and that damages and other appropriate equitable relief be awarded. A.179-80.

The District Court and the Court of Appeals both held that "mailing the proxy statement was unlawful" under Section 14(a) of the Act (A.1011), because of its "omission of a material fact necessary in order to make the statements therein not misleading." *Id.* The District Court and the Court of Appeals both found that without the votes of the minority stockholders, obtained through the unlawful proxy solicitation, approval of the merger was not achieved. A.1011.[2]

Having made these findings, the District Court entered "summary judgment . . . on the issue of liability alone" (Fed. R. Civ. P. 56(c)), in the nature of a declaratory judgment for petitioners. A.690. "Relief was left for further consideration after hearings before a special master and a report thereon." A.1012.

The Court of Appeals held that, although the proxy statement was materially misleading, the facts did not suffice to establish the requisite causal relationship between the proxy statement and the merger, because in its view "the more exact question is whether the misleading statement and omission caused the submission of sufficient proxies." A.1013.

---

[2] "[T]he merger required favorable votes representing at least two-thirds of the Autolite shares, and in order to count a two-thirds vote, one must include votes which were cast by authority of proxies obtained by the challenged solicitation." A.1011.

This formulation of the question was thought to follow from the court's premise that liability is not established unless "the unlawful act caused some inequity or damage which the court should relieve or redress." A.1011. The opinion assumed that there would be no inequity or damage to be relieved or redressed if the trial judge were satisfied of the probability that "the merger would have received a sufficient vote even if the proxy statement had not been misleading". A.1013. The Court of Appeals acknowledged that this approach corresponds to the common law fraud test, "whether the injured party relied on the misrepresentation." A.1013, n.10. It eschewed direct resolution of that question, however, on the ground that "[r]eliance by thousands of individuals, as here, can scarcely be inquired into." *Id.* It resorted, instead, to indirect resolution, predicated upon a presumption that stockholders would have voted for merger, regardless of misrepresentation, if "the merger has merit and the terms were in fact fair and equitable to the minority shareholders." A.1012. With the aid of this presumption, the court below was able to conclude: "The material offered by defendants on the merits of the terms of merger suggests that it may be possible for them to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013.

On this approach, if respondents could satisfy the court of the merit and fairness of the substantive terms, then, regardless of the material violation, "there would be no sound basis for disruption of the merger *or other relief*." A.1013 (emphasis added). The Court of Appeals' express rationale was its unwillingness "to unscramble a corporate

transaction merely because a violation occurred." A. 1013-14.

The court rejected petitioners' claim that legal injury consists of the invasion, through material misrepresentation, of the right of Auto-Lite to continue its corporate existence, and of its shareholders as a class to preserve that status, until altered through authorization obtained in accordance with law, and that merit or fairness of the substantive terms is therefore irrelevant to the issue of liability. A.1012.

Accordingly, the court reversed the adjudication of liability and remanded the cause for a trial, in effect, on the "merits of the terms of merger" (A.1013), assessing all costs of the appeal, amounting to approximately $9,000, against petitioners. A.1015.

SUMMARY OF ARGUMENT

The Court of Appeals erred in adopting a test of causation which requires a trial determination on the issue whether the misleading omission in the proxy statement changed the minds of sufficient shareholders to alter the result of the election, and compounded the error by ruling that this issue is governed by the merit and fairness of the merger in its substantive terms. The decision is in direct conflict with:

I. the express holdings of this Court in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964);

II. the congressional purpose to eliminate reliance, and causal tests derived from it, from the cause of action for breach of a disclosure statute compelling general dissemination of full and complete information to investors at large;

III. the practical limits of judicial trial processes when the issue is the effect of nondisclosure on mass mental processes;

IV. the congressional purpose to protect the shareholders' right to a free and informed vote (and conflicts as well with common experience), in presuming that shareholders would approve any fair merger;

V. the necessity for effective private remedies to supplement SEC action in the enforcement of the Act.

This Court's decision in *J. I. Case* v. *Borak* is dispositive. It held that the Securities Exchange Act of 1934 creates "a federal cause of action for rescission or damages . . . with respect to a consummated merger which was authorized pursuant to the use of a proxy statement . . . contain[ing] false and misleading statements violative of §14(a) . . . ." In direct conflict with this Court's decision, the Court of Appeals held that no cause of action is created even though the proxy solicitation made use of a proxy statement violative of the Act and produced votes essential to merger approval, unless an additional requirement of "causation" is met by a finding that the stockholders would not have approved the merger without the misleading statements and omission. This superadded element of the cause of action, effectively negating *Borak,* was derived by the Court of Appeals from the "corresponding" test of reliance in common law fraud cases. But Congress, in enacting compulsory disclosure statutes like §14(a), assumed reliance and fostered it, in the interests of public confidence in the securities market and of the prophylactic values of exposure. It thus eliminated reliance — or a test of causation derived from it — as an element of the private remedy. Thus the proper test of causation, under *Borak,* asks whether the proxy

solicitation, itself the violation, caused the merger, as it did here, not whether the particular misstatement or omission caused enough investors to change their minds to alter the outcome of the vote.

The Court of Appeals' transformation of causation into reliance inevitably entangles the court in an impracticable inquiry into the mental processes of thousands of stockholders. Confronted with this impossibility, a court can give effect to the statutory command only by accepting the congressional finding that the public will rely on documents compulsorily disseminated to investors at large, and then by taking appropriate remedial action upon the basis of the intended, reasonable, and probable tendency of the misrepresentation. A trial could add nothing.

Compounding the error, the presumption that stockholders would approve any fair merger, devised by the Court of Appeals to escape the impracticalities of direct proof of mental processes, defies common experience as a matter of fact, and destroys the right of corporate suffrage which Congress sought to protect as a matter of law. Judicial appraisal of the substantive merit of the merger cannot replace the stockholders' free and informed vote. Beyond circumventing stockholder choice, the ruling makes the statute a superfluous condemnation of unfair mergers, merely restating the common law rule of "constructive fraud," and gives the investor fewer remedies than the common law affords in cases of actual fraud or nondisclosure of conflicts of interest, in which fairness is no defense.

By inviting corporate insiders to wage a war of attrition through exhaustive litigation of the fairness of the merger — or of any other factor which might bear on the prob-

ability that the shareholder vote was unaffected — the Court of Appeals' decision will discourage private enforcement by small shareholders, not only under §14(a) but under all securities laws, and will destroy the private action as an effective weapon, and a necessary supplement to Commission action, in the enforcement of federal policy for the protection of investors.

The findings affirmed by the Court of Appeals complete the cause of action and establish liability, entitling petitioners to immediate judgment in their favor, including at least a declaratory judgment and accounting, nominal damages, counsel fees and costs, for vindicating the corporate right and enforcing the policy of the Act. In the further proceedings correctly directed by the District Court, relief through specific rescission of the merger is not foreclosed by its consummation, and may be necessary to "make effective the congressional purpose," as declared in *Borak* and *National Securities*. Alternative relief in money restitution, as a traditional remedy in securities cases, is available to compel respondents to disgorge the fruits of their proven wrong.

ARGUMENT

I. THE SEVENTH CIRCUIT'S DENIAL OF ANY LIABILITY OR REMEDY FOR A MATERIAL VIOLATION OF THE ACT CONFLICTS WITH THIS COURT'S DECISION IN J. I. CASE CO. v. BORAK

The judgment of the Court of Appeals, and the rationale of the third section of its opinion under the heading "*The causal relationship and appropriate relief*", are in direct conflict with the unanimous decision of this Court in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) (hereafter cited "*Borak*"). The explicit holdings of this Court squarely refute, by direct contradiction, every supposed reason offered by the court below to support its reversal of the District Court. In short, this Court has already decided this case, and summary reversal is called for.

A side-by-side comparison of this Court's *Borak* opinion with the third section of the Court of Appeals' opinion reveals irreconcilable conflict and frontal collision on every salient point:

1. *The necessity of relief when federally secured rights are invaded.* The whole thrust of this Court's decision in *Borak* is "'to grant the necessary relief' where federally secured rights are invaded." 377 U.S. at 433. Relief must follow upon a violation because "if the law . . . happened to attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated." 377 U.S. at 434-35. That congressional purpose, "to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy

solicitation" (377 U.S. at 431), creates "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." 377 U.S. at 433.

In the teeth of this Court's command, and in the face of its own unequivocal holding that respondents were guilty of a clear violation of the Act, the Court of Appeals concludes that this invasion of federally secured rights provides "no sound basis for disruption of the merger *or other relief*." A.1013 (emphasis added). In its view, a violation of the Act carries no consequences; a court has no duty — or power — to act without a further showing that "the unlawful act caused some [other] inequity or damage which the court should relieve or redress." A.1011. Because the Court of Appeals does "not consider that the policy of the '34 act requires the court to unscramble a corporate transaction merely because a violation occurred" (A.1013-14), it holds that no liability exists, and that *no* remedy — even declaratory — can be granted, "*merely* because a violation occurred." *Id.* (emphasis added).

To replace this Court's command in *Borak*, the Seventh Circuit thereupon announces its own rule, devised through tortuous transformation of causation into reliance, and reliance into fairness, that the violators of federal law are immune so long as the court finds "that the merger has merit and the terms were in fact fair and equitable to the minority shareholders". A.1012. The ruling is well calculated to eviscerate "[t]he purpose of §14(a) . . . to prevent management . . . from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation." 377 U.S. at 431. Virtually any corporate transaction, no matter how fraudulently

induced, may nonetheless be defensible as substantively "fair", and since the Seventh Circuit's rule would "attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated." 377 U.S. at 434-35. This Court imposed in *Borak* a judicial duty to enforce the congressional declaration that it is unlawful to obtain authorization for corporate action through inadequate or deceptive disclosure in proxy solicitation. The Court of Appeals was powerless to override that judgment, and to arrogate to itself the right to decide that in such a case there is no "inequity or damage which the court should relieve or redress." A.1011.

2. *The components of the statutory cause of action.* In *Borak* this Court held that "§27 of the Act authorizes a federal cause of action for rescission or damages to a corporate stockholder with respect to a consummated merger which was authorized pursuant to the use of a proxy statement alleged to contain false and misleading statements violative of §14(a) of the Act." 377 U.S. at 428. These component elements, as *Borak* held, complete a federal "claim upon which relief can be granted" under Rule 12(b)(6), Fed. R. Civ. P., without regard to the form of appropriate relief. The Court specifically disapproved other lower court decisions adding non-federal requisites to the cause of action, in the light of "the overriding federal law applicable here" (377 U.S. at 434), and because "the hurdles that the victim might face" if state or common law requirements were interposed "might well prove insuperable to effective relief." 377 U.S. at 435.

The Court of Appeals agreed with the District Court that this "consummated merger was authorized pursuant

to the use of a proxy statement . . . contain[ing] false and misleading statements violative of §14(a) of the Act." *Borak*, 377 U.S. at 428. With the requisite elements thus established, the District Court had properly adjudged the issue of liability, and ordered further hearings on the relief to be granted. In direct contravention of *Borak's* enumeration of the components of the statutory cause of action, the Court of Appeals reversed, holding that these elements did not establish liability, and that no remedy could be considered — and none could be granted — until a trial had been held and determination made on the further question whether the stockholders might have approved the merger if the proxy statement had not contained misleading statements.

The Seventh Circuit constructed this supposed issue by adding two extraneous requirements to the private "right under §27 to bring suit for violation of §14(a)" (377 U.S. at 430): *reliance* and *unfairness*. By importing a requirement of *reliance*, borrowed from "common law fraud" (A.1013, n. 10) and converted to a test of causation, the Court of Appeals violated *Borak's* teachings and adopted "the rejected argument that the elements of technical common-law fraud . . . must be established" in a suit to enforce the securities laws. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200 (1963). By engrafting a requirement of *unfairness* onto the statutory cause of action, the Court of Appeals again violated the *Borak* principles, as subsequently confirmed by this Court's holding that "[t]he gravamen of the complaint was the misrepresentation, not the merger", and that approval of the merger's substantive terms under state law does not affect the federal cause of action for unlawful proxy solicitation. *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 462 (1969).

3. *The causal relationship between the proxy solicitation and the merger.* In *Borak,* this Court noted that Congress' "broad remedial purposes are evidenced in the language of the section which makes it 'unlawful for any person . . . to solicit any proxy . . . in contravention of'" SEC rules. 377 U.S. at 431-32. "[T]o make effective the congressional purpose" thus delineated (377 U.S. at 433), unlawful proxy solicitation creates the judicial duty to provide a remedy. The requisite "causal relationship of the proxy material and the merger" (377 U.S. at 431) is satisfied when there is "corporate action pursuant to a deceptive proxy solicitation". 377 U.S. at 432. No more is required than that the "consummated merger . . . was authorized pursuant to the use of a proxy statement . . . contain[ing] false and misleading statements violative of §14(a) of the Act." 377 U.S. at 428.

The Court of Appeals conceded that this causal test as laid down in *Borak* had been fully met. It found unequivocally that respondents had violated federal law in failing to disclose material facts in their proxy statement, and therefore that "mailing the proxy statement was unlawful." A.1011. The Seventh Circuit also found unequivocally that the merger constituted "corporate action pursuant to a deceptive proxy solicitation" and "was authorized pursuant to the use of a proxy statement . . . violative of §14(a)" (*Borak,* 377 U.S. at 432), since the votes of the minority shareholders produced by the proxy solicitation were numerically essential to a favorable total vote.[8] The opinion is explicit: "It is clear

[8] To obtain the required two-thirds vote, respondents needed favorable proxies from approximately 27% of the minority shares. The proxy solicitation produced favorable votes from about 60%. A.687-88.

. . . that in order to count [the required] two-thirds vote, one must include votes which were cast by authority of proxies obtained by the challenged solicitation. The District Court concluded that since this is so, the proxy statement was a cause of the merger . . . ." A.1011-12.

The Seventh Circuit flatly rejects the test of causation declared in *Borak* and correctly applied by the District Court.[4] It prefers instead "the more exact question . . . whether the misleading statement and omission caused the submission of sufficient proxies." A.1013. Unsatisfied by the fact that the unlawful proxy solicitation caused the merger, and insistent upon proof of "causal relationship between the *deficiency* in the proxy statement and the merger" (A.1012), the Court of Appeals departs from reality and enters the realm of conjecture. The hard facts of the actual occurrence answer this Court's test of whether the proxy solicitation caused the merger. To answer the Seventh Circuit's test of what "might have been", the only source is conjecture and speculation about a hypothetical situation where the shareholders are deemed to have known what in fact they did not know. In this unreal world, the trier of fact is told to look back and to count how many shareholders would have changed their minds, to determine whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013. This phrasing of the question substitutes a purely metaphysical exercise for the practical and realistic factual determination directed by this Court's test.

---

[4] See also *Laurenzano* v. *Einbender*, 264 F.Supp. 356, 361 (E.D.N.Y. 1966), denying dismissal for lack of causation so long as the unlawful "proxy solicitation . . . was calculatedly infused into the matrix of the transactions . . . ."

4. *The necessity for effective private enforcement after the merger is consummated.* This Court in *Borak* declared that Congress had authorized a private cause of action "with respect to a consummated merger" because "[p]rivate enforcement of the proxy rules provides a necessary supplement to Commission action" and "serves as a most effective weapon in the enforcement of the proxy requirements." 377 U.S. at 428, 432. For these reasons, the Court found no "merit in the contention that such remedies are limited to prospective relief" (377 U.S. at 434), and rejected the application of state law which might "attach no responsibility to the use of misleading proxy statements" or raise "hurdles . . . [which] might well prove insuperable to effective relief." 377 U.S. at 435.

In contrast, the Court of Appeals had "no question but that . . . corrective measures [in the form of prospective relief] would have been appropriate" on the established facts, but held that no such "corrective measures" were permissible when "the matter did not really come before the court until too late for preventive action." A.1011. In its view, consummation of the merger required use of a different standard to "determine in retrospect whether the unlawful act caused some inequity or damage which the court should relieve or redress." A.1011. The stated rationale for the different standard of liability is the reluctance of "the court to unscramble a corporate transaction merely because a violation occurred." A.1013-14. This reluctance led the Court to overreact, by fashioning a sweeping test of causation—not of appropriate relief—which left "no sound basis for disruption of the merger *or other relief.*" A.1013. (emphasis added).

This denial of *all* relief because of reluctance to grant *specific* relief defies this Court's *Borak* commands in two

separate respects. First, the reluctance to "unscramble" conflicts directly with this Court's pronouncement that "there is no reason to emasculate the securities laws by forbidding remedies which might prove to be essential. *Cf. J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964). On remand, the trial court may order a return to the *status quo ante* . . . ." *SEC* v. *National Securities, Inc.*, 393 U.S. 463-64 (1969). Second, in *Borak* this Court specifically enumerated alternative monetary remedies in "damages" or "restitution", which might be employed in lieu of specific rescission to discharge "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." 377 U.S. at 433. *Borak* itself involved a merger already consummated, and the duty it imposed is the duty to provide effective remedies at *that* time, not when prospective relief is sought.

The Court of Appeals disregards that duty by laying down a rule for consummated mergers which will exculpate the fraudulent proxy solicitor in every case where the merger is found to be within the limits of fairness when measured by the merits of its substantive terms. Moreover, exculpation is likely to be universal as a practical matter, and the possibility of relief if fairness is not found, held out by the Seventh Circuit's rule, will prove illusory in practice. By requiring an expensive and exhaustive trial of the merits of the corporate transaction as a pre-condition to a determination of liability in every suit, the decision below will effectively stifle enforcement by small shareholders like these petitioners. The Seventh Circuit's holding, if unreversed, will thus emasculate this Court's *Borak* decision and its animating purpose to encourage private enforcement actions.

5. *The interest to be protected in merger cases.* In *Borak* this Court declared that "To hold that derivative actions are not within the sweep of the section would . . . be tantamount to a denial of private relief." 377 U.S. at 432. Such actions, to vindicate the interests of the corporation rather than of the stockholder, are essential to effective enforcement because "The injury which a stockholder suffers from corporate action pursuant to a deceptive proxy solicitation ordinarily flows from the damage done the corporation, rather than from the damage inflicted directly upon the stockholder." 377 U.S. at 432. When the corporate action at stake is merger into another corporation, as here, the "damage done the corporation" is, inevitably, the extinguishment of its corporate existence and the invasion of its right to continue to do business unless and until dissolved by authorization lawfully procured. Reaffirming this aspect of its *Borak* decision, the Court has ruled that misleading proxy solicitation is actionable under federal law, despite approval of the merger under state law, when the "deception furthered a scheme which resulted in their losing their status as shareholders in [the original corporation] and becoming shareholders in a new company." *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969).

In the face of this binding authority, the Court of Appeals discarded the petitioners' position "that Autolite had a right to a separate existence which the court must vindicate against unlawful interference, and [their] claim [of] their own rights to be shareholders of Autolite, unaffected by votes at a meeting where the information supplied to the electorate did not meet the standards of the 1934 act." A.1012. The invasion of these interests, in that court's opinion, did not amount to any "inequity or damage which the court should relieve or redress." A. 1011.

This disregard of *Borak's* authority ignores as well the explicit declaration of Congress that the merger contract, made in violation of the Act, is "void" insofar as the rights of the violator are concerned. Section 29(b), Securities Exchange Act of 1934, 15 U.S.C. §78cc(b). This declaration precludes exculpating a transaction authorized by votes illegally solicited on the theory that the illegal solicitation was "harmless." The Fifth Circuit recognized this in *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F.2d 357, 362 (5th Cir. 1968), *cert. denied*, 393 U.S. 913 (1968), holding that the right to relief against violation of the 1934 Act is not conditioned upon establishment "that any harm which [plaintiffs] suffered was caused by" the violation; "it is sufficient to show merely that the prohibited transaction occurred and that [plaintiffs] were in the protected class." As *Borak* held, the "protected class" under §14(a) includes the corporation itself. When Congress has labelled the transaction "void", the courts are foreclosed from validating the merger by exculpating the violators, or from holding that consummation confers immunity and the transaction is exempt merely because it is considered to be substantively "fair" in its terms.

6. *The stockholders' right to fair corporate suffrage.* Speaking to the basic purpose of §14(a), the unanimous opinion of this Court in *Borak* states, "The section stemmed from the congressional belief that '[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange.' H.R. Rep. No. 1383, 73rd Cong., 2d Sess., 13. It was intended to 'control the conditions under which proxies are solicited with a view to preventing the recurrence of abuses which . . . [had] frustrated the free exercise of the voting rights of stockholders.' *Id.*, at 14." 377 U.S. at 431.

The Court of Appeals, however, ignores this declaration of purpose and is unconcerned by the corruption of the corporate suffrage. The "free exercise of the voting rights of stockholders" finds no vindication in the opinion of the court below, which refuses to "deem liability established because some of the required votes depended for validity on proxies secured by the unlawful proxy statement" (A.1013), and declines to countenance the shareholders' claimed right to be "unaffected by votes at a meeting where the information supplied to the electorate did not meet the standards of the 1934 act." A.1012. On the contrary, the Seventh Circuit by-passes the shareholders' right to a free and informed vote by embarking upon a hypothetical judicial reconstruction of the balloting, after the fact, to determine whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013. The answer to this question, in the Seventh Circuit's view, turns on prediction whether the minority shareholders of Auto-Lite would be as well off as preferred shareholders of the new corporation as they would have been as continuing shareholders of Auto-Lite. This retrospective prediction necessarily entails projection and comparison of the relative prospects of the dissolved corporation with that of the merged corporation. But that is one of the questions which the respondents illegally deprived the minority shareholders of their federally protected right intelligently to explore and resolve for themselves. To allow the court to cast their votes for them, in effect, in a judicial reenactment of the voting process, denies all right and value to the right of suffrage conferred and guarded by Congress, and enforced by this Court's decision in *Borak*.

II. BY EXPRESSLY COMPELLING PUBLIC DISCLOSURE PREDICATED UPON INVESTOR RELIANCE, CONGRESS FORECLOSED JUDICIAL INQUIRY INTO THE ACTUAL EFFECT ON SHAREHOLDER MENTAL PROCESSES

The root of error below is the Seventh Circuit's resort to the common law doctrine of "reliance" to limit the sweep of the federal securities laws. That doctrine, which the opinion admittedly imports from the field of "common law fraud" (A.1013, n. 10), actually becomes the foundation for the "corresponding" test of causation devised by the court below in its misinterpretation of *Borak*. Its ruling in this regard effectively reversed the District Court's correct holding that to require "reliance" would conflict with the underlying purpose of Congress' condemnation of misleading proxy solicitation, with the letter of §14(a) and Rule 14a-9 in their explicit terms, and with the practical necessities of enforcement of both spirit and letter.

A. The Congressional Finding of Public Reliance Was Erroneously Disregarded by the Court Below

The soundness of the District Court's rejection of reliance—and of causal requirements derived from it—is revealed in the statutory pattern of the securities laws. A proxy statement *must* accompany every solicitation for a proxy, consent, or authorization for corporate action within the Act's coverage; a proxy form may not be supplied to shareholders without the required statement. Its contents are broadcast to the investing public at large, in obedience to congressional command. In this

respect, the proxy statement is the counterpart[5] of the prospectus for newly issued securities which must be sent to every prospective purchaser under §5(b) of the Securities Act of 1933.

The general dissemination of these documents fulfills "a central aspect of national policy in the field of securities regulation", assuring that investors have "access to enough information to enable them to arrive at their own rational decisions." THE WHEAT REPORT 10.[6] Addressed to the average unsophisticated investor rather than to the informed specialist, they are intended by Congress to supply the basis for action by the recipient. The requirement that such information must be supplied is founded upon the congressional premise that investors should and will make use of it. In short, a legislative finding of reliance is the statutory foundation. Management may not excuse a failure to send the required document by asserting that the recipients would not read it anyway, nor may it avoid the consequences of a misleading statement by claiming that it was not read or relied upon in fact. A statement broadcast to the investing public will have inevitable if undiscernible effects upon the market as a whole, affecting every transaction in the security to

---

[5] THE WHEAT REPORT recognizes the parallel between the function of the proxy statement in providing disclosure to the trading market in previously issued securities and the function of the prospectus in the marketing of new issues. DISCLOSURE TO INVESTORS, REPORT AND RECOMMENDATIONS TO THE SECURITIES AND EXCHANGE COMMISSION FROM THE DISCLOSURE POLICY STUDY, "THE WHEAT REPORT," 41, 376-77 (March 27, 1969) (hereinafter cited as THE WHEAT REPORT). In mergers and other corporate combinations, the proxy statement and prospectus operate interchangeably to serve the federal policy of disclosure. *Id.* at 74, 277, 381.

[6] See note 5, *supra.*

some degree. Congress has required disclosure in the belief that the public should have an affirmative source of information on which they can rely, and has created conditions designed to invite and to foster that reliance. The courts are not free to call this policy into question, nor to impede its effectuation through decisions which tend to discourage the very reliance which Congress meant to promote.

Whether investors in any case *do* rely, or *are* misled, is accordingly irrelevant, for in Congress' view, material non-disclosure inevitably *tends* to deprive investors of information which they should have and inevitably *tends* to mislead. *Cf. Rogers* v. *Guarantee Trust Co.*, 288 U.S. 123, 143 (1933). Because the evil at which Congress struck was this tendency, whether investors actually did rely on or were misled by a material non-disclosure is no more relevant in a Section 14(a) case than the question whether employees were actually coerced by employer "interference, restraint or coercion" is relevant in an unfair labor practice case.[7] "It is the *tendency* of [unlawful conduct] to weaken or destroy [statutory rights] that is controlling." *NLRB* v. *Burnup & Sims*, 379 U.S. 21, 23-24 (1964) (emphasis added).

---

[7] The Seventh Circuit's holding in *NLRB* v. *Illinois Tool Works*, 153 F.2d 811, 814 (1946), is a classic statement of the rule:

> "[T]he test of interference, restraint and coercion under §8(1) of the Act does not turn on the employer's motive or on whether the coercion succeeded or failed. [Citations omitted.] The test is whether the employer engaged in conduct which, it may reasonably be said, tends to interfere with the free exercise of employee rights under the Act." (Citations omitted.)

B. The Congressional Purpose of Compulsory Disclosure Excludes Consideration of Actual Deception

The Seventh Circuit considered the controlling question to be whether the particular misleading statement actually "caused the submission of sufficient proxies." A.1013. The court noted that at common law the question would be phrased in terms of reliance. A.1013, n. 10. This resort to reliance stemmed from a misconception of the statutory purpose of *disclosure*.[8] Anti-fraud provisions of the securities acts, reinforcing the common law, are sufficient to condemn actual deception in securities transactions. Reaching beyond these narrow confines, Congress added Section 14(a) to condemn silence, not falsehood, and to command "Tell the full story", not merely to repeat "Tell no lies." Congress requires "not simply truth in the statements volunteered, but disclosure." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963), quoting SHULMAN, *Civil Liability and the Securities Act*, 43 YALE L.J. 227, 242 (1933). With Congress' authority, the SEC proxy rules affirmatively compel the revelation of specified information. The proxy solicitor may not remain silent, saying he misled no one because he said nothing; he has the duty to speak.

The distinctive public purpose of disclosure is two-fold. First, the stability of the securities market depends upon the confidence of the investing public in the completeness and reliability of information provided. The effects of the decision below were foreseen by the late Judge

---

[8] The need for judically tailored private remedies, unrestricted by ordinary common law requirements, is "strongest when the rule imposes an explicit duty unknown to the common law." *Colonial Realty Corporation* v. *Bache & Co.*, 358 F.2d 178, 182 (2d Cir. 1966), *cert. denied*, 385 U.S. 817 (1966).

Jerome Frank: "The unfortunate consequences will be that those in control may be immunized from effective attacks on their misdeeds, and, as a result, the small investors will lose confidence in all corporate managements, the honest as well as the dishonest." *Subin* v. *Goldsmith*, 224 F.2d 753, 767 (2d Cir. 1955) (dissenting opinion). Whether or not anyone is actually deceived, concealment of conflicts of interest by those who undertake to advise will inevitably undermine that investor confidence which is vital to a sound economy. Speaking of such an undisclosed conflict of interest in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 201 (1963), this Court confirmed this special function of disclosure: "Experience has shown that disclosure in such situations, while not onerous to the adviser, is needed to preserve the climate of fair dealing which is so essential to maintain public confidence in the securities industry and to preserve the economic health of the country."

The second object of compulsory disclosure, also independent of fraud, reliance, or actual deception, is found in the prophylactic function of exposure. Thus, "one of its most valuable consequences is the elimination of conflicts of interest and questionable business practices which, exposed to public view, have what Justice Frankfurter once termed 'a shrinking quality.'" The Wheat Report, *supra* note 5, at 51. In Justice Brandeis' words, "Sunshine is said to be the best of disinfectants and electric light the most efficient policeman." Brandeis, Other People's Money c. V, 62 (NHLF ed. 1914). "The Act presupposes that the glaring light of publicity will give the investors needed protection. . . . [T]he requirement that the truth about securities be told will in and of itself prevent some fraudulent transactions which cannot stand the scrutiny of

publicity." DOUGLAS, *Protecting the Investor*, 23 YALE REV. (N.S.) 508, 523-34 (1933), quoted in THE WHEAT REPORT, *supra* note 5, at 53. In the context of undisclosed conflict of interest, this Court observed, "Failure to disclose material facts [is unlawful] for, as the experience of the 1920's and 1930's amply reveals, the darkness and ignorance of commercial secrecy are the conditions upon which predatory practices best thrive." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200 (1963).*

Nondisclosure of material facts, such as conflict-of-interest relationships, undermines public confidence in the securities market and provides a cloak for predatory practices, without regard to whether any investor is actually induced by ignorance to take specific action which he would not have taken with knowledge of the facts. The Seventh Circuit's reliance-causation test is wholly alien to the congressional purposes of compulsory disclosure: to preserve investor confidence in the securities

---

* This two-fold purpose of disclosure, apart from the prevention of actual deception, is summarized in the SEC's special study of the disclosure policy of the securities laws:

> "Disclosure is and has from the outset been a central aspect of national policy in the field of securities regulation. The emphasis on disclosure rests on two considerations. One relates to the proper function of Federal government in investment matters. Apart from the prevention of fraud and manipulation, the draftsmen of the '33 and '34 Acts viewed that responsibility as being primarily one of seeing to it that investors and speculators had access to enough information to enable them to arrive at their own rational decisions. The other, less direct, rests on the belief that appropriate publicity tends to deter questionable practices and to elevate standards of business conduct." THE WHEAT REPORT, *supra* note 5, at 10.

markets as places of fair and open dealing, and to deter overreaching and questionable conduct, through the prophylaxis of public scrutiny. The injection of the extraneous reliance-causation requirement into enforcement suits obstructs achievement of these legislative goals.

C. The Statutory Scheme Eliminates Reliance as an Element of the Civil Remedy

Combating the dual evil of nondisclosure — undermining public confidence and fostering secrecy for predatory practices — is a principal object of the proxy statement and of the prospectus. Judicial inquiry into "reliance" on these documents, or into kindred questions of causation, is forbidden by the letter of these disclosure laws as well as by their spirit. When Congress has intended to require reliance as a condition to civil liability for breach of a statutory command, it has imposed the requirement explicitly. For example, reliance is specifically stated as a prerequisite to the statutory civil remedies created for violations of the filing requirements of the 1933 and 1934 Acts, directing registration with and reporting to the SEC. Filing is intended primarily to facilitate official surveillance, and only incidentally to inform the investing public by a process of "filtration" through experts.[10] Since neither the purpose nor the probability is to reach the typical investor, there is no statutory premise of reliance, and there is need for a factual inquiry into whether the false report or registration statement influenced the decision of the particular investor who complains.[11]

---

[10] *See* THE WHEAT REPORT, *supra* note 5, at 52-53.

[11] Under §11 of the 1933 Act, it is a defense that the security buyer knew the truth, and if the falsehood in the registration statement has been corrected by a sub-

Anti-fraud sections of the securities laws cover individual transactions with their particularized communications, where no general duty to provide a written statement is imposed. In such cases, broadly analogous to common law actions for fraud or deceit, there may be justification for requiring proof not only that some misrepresentation was made, but that it was also relied upon.[12]

On the other hand, in providing the civil remedy for violation of a duty to supply the investing public with full and truthful written statement of material information, Congress intentionally omitted any requirement of reliance. Under Section 12 of the 1933 Act (15 U.S.C. §77*l*), the violation of the prospectus requirements, without more, creates liability in favor of the purchaser, and gives him a right to rescission and restitution, to recover the consideration paid, or for damages. This strict liability "was intended to substantially change the common law concept of liability for fraud and deceit" and "to ensure the full and truthful disclosure of all perti-

---

[11] (Continued)
sequent earning statement, reliance must be shown, although without proof of the reading of the registration statement. 15 U.S.C. §77k. Under §18(a) of the 1934 Act, a parallel requirement of reliance is imposed upon the civil remedy for falsehood in any registration statement, application, report, or document filed with the SEC under that Act. 15 U.S.C. §78r.

[12] Under anti-fraud sections like §17 of the 1933 Act (15 U.S.C. §77q) and §10(b) of the 1934 Act (15 U.S.C. 78j(b)), absent some fiduciary relationship, reliance has been judicially required. See *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 462-64 (2d Cir. 1965). *But see Myzel* v. *Fields*, 386 F. 2d 718 (8th Cir. 1967) *cert. denied*, 390 U.S. 951 (1968); *Voege* v. *American Sumatra Tobacco Corporation*, 241 F. Supp. 369 (D. Del. 1965).

nent facts to undisclosed and unidentified prospective purchasers, and to leave the fraud remedies . . . to the more intimate and isolated transactions involving known or identifiable prospective purchasers." *Woodward* v. *Wright*, 226 F. 2d 108, 116, 115 (10th Cir. 1959). Congress meant to impose a heavy burden of "responsibility for reprehensible acts of omission or commission on those who purport to issue *statements for the public's reliance*". *See* H. R. REP. No. 85, 73d Cong., 1st Sess. 9 (1933); 266 F. 2d at 116. (Emphasis added).

> "Having explicitly prescribed the conditions of recovery in rescission or damages, we cannot read other common law requirements into the 'special right'. To say that purchaser reliance is a prerequisite to seller liability is to import something into the statute which is not there. See [2 LOSS, SECURITIES REGULATION, 966, 999 (1st ed. 1951)]. The statement in the prospectus mailed to the appellants contained material false statements. The trial court so found and there can be no doubt about it. They were communicated for the purpose of inducing the appellants to purchase the oil properties. ... We think the proof brought the appellants within the remedy afforded by [the statute] and they are entitled to recover thereunder." (*Woodward* v. *Wright*, 266 F. 2d 108, 116 (10th Cir. 1959)).

The same policy controls when, as here, a defendant seeks to introduce the question of reliance in the guise of causation. In *DeMarco* v. *Edens*, 390 F. 2d 836 (2d Cir. 1968), the Second Circuit rejected the argument that the required written statement did not "cause" the investor's purchase when it was not delivered until after the transaction was completed. "Were we to support appellees' contention we would, in effect, be erroneously introducing an element of reliance into the construction of Section 12(2)." 390 F. 2d at 841.

In *Borak*, this Court found an implied civil "cause of action for rescission or damages" for a violation of §14(a) of the 1934 Act (377 U.S. at 428), analogous to the statutory civil cause of action "for rescission or damages" for a violation of §5 of the 1933 Act. In fashioning this civil remedy, this Court cited and relied upon its decision involving the statutory civil remedy afforded by §12 of the 1933 Act. The parallel in remedies needed to enforce the parallel purpose and disclosure duty was recognized: "In passing on almost identical language found in the Securities Act of 1933, the Court found the words entirely sufficient to fashion a remedy to rescind a fraudulent sale, secure restitution and even to enforce the right to restitution against a third party holding assets of the vendor. *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282 (1940)." *Borak*, 377 U.S. at 433. Consistently with the statutory pattern, the implied civil remedy for a deficient proxy statement thus matches the statutory civil remedy for a deficient prospectus,[13] enforcing the common congressional purpose in requiring that full and truthful information be furnished to each member of the investing public whose action the solicitor seeks to induce, whether giving a proxy or buying stock.[14] In either case, no requirement of "reliance" is imposed.

---

[13] The Wheat Report has recommended that this judicially implied remedy should be confirmed by administrative action, to make explicit the availability of the remedy of §12 of the 1933 Act in mergers and other corporate combinations "if the disclosure document used in soliciting the votes of shareholders of the acquired corporation is defective". The Wheat Report, *supra* note 5, at 277-78.

[14] It is to be noted that when a proxy statement is used to solicit proxies for approval of a merger, those whose proxies are sought are prospective purchasers of the surviving corporation's securities as well as voters. *See, e.g.*, *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 467 (1969).

D. The Relevant Causal Relationship Is Between the Unlawful Proxy Solicitation and the Merger

The letter of §14(a) confirms the absence of any requirement of reliance, and the irrelevance of any inquiry into whether investors were actually misled. To "provide such remedies as are necessary to make effective the congressional purpose", that is, the "broad remedial purposes . . . evidenced in the language of the section which makes it 'unlawful for any person . . . to solicit . . . any proxy . . . in contravention . . . '" of the SEC rules, this Court held that "private parties have a right under §27 to bring suit for a violation of §14(a) of the Act." *Borak*, 377 at 433, 431-32, 430-31. The *violation* which alone creates the necessary remedy is the *solicitation* of the proxies, not the specific misstatement or omission. Congress did not merely condemn transactions effectuated through fraud or deceit, elsewhere prohibited; the offense is the solicitation itself, when the proxy statement makes "deceptive or inadequate disclosure". *Borak*, 377 U.S. at 431. Thus both courts below correctly held "that mailing the proxy statement was unlawful under 15 U.S.C. Sec. 78n(a) (sec. 14(a))." A.1011.

The test of causation is correspondingly confined to "the causal relationship of the proxy material and the merger...." *Borak*, 377 U.S. at 431. The question is only whether the "consummated merger . . . was authorized pursuant to the use of a proxy statement . . . contain[ing] false and misleading statements violative of §14(a) of the Act", (*Id.*, at 428), or whether there was any "corporate action pursuant to a deceptive proxy solicitation" *Id.*, at 432.

The Court of Appeals, however, demanded the answer to "the more exact question . . . whether the misleading statement and omission caused the submission of suffi-

cient proxies." A. 1013. The causal test laid down by this Court, between "the proxy material and the merger," is narrowed to the "more exact" test of the "causal relationship between the *deficiency* in the proxy statement and the merger." A. 1012 (emphasis added). Through this re-writing of the question, the Court demands more than a showing that votes produced by the unlawful solicitation were essential to, and did, authorize the merger; it demands a showing that a sufficient number of votes were actually changed by the specific misleading omission to bring about a different result.[15] It thus imports the fraud test under which a plaintiff must prove he "relied" on the falsehood, and further requires, beyond the common law, that this "reliance" must have tipped the scales. Although the Court of Appeals shifts the burden of proof, petitioners are still compelled to litigate this impalpable issue and to produce evidence of some kind

---

[15] In labor elections, the Seventh Circuit has taken a strikingly different approach. See *Allis-Chalmers Manufacturing Company* v. *NLRB*, 261 F. 2d 613 (7th Cir. 1959); *Celanese Corporation of America* v. *NLRB*, 279 F. 2d 204 (7th Cir. 1960), *vacated for reconsideration*, 365 U.S. 297 (1961) *on remand*, 291 F. 2d 224 (7th Cir. 1961), *cert. denied* 368 U.S. 925 (1961). When mailings are sent to employees in a representation campaign, misleading omissions void the election, with no hesitation for speculation about whether the same vote would have followed because the winning union had "merit", or whether the union members "relied" on the mailed statement or its misleading portions. The objectors are not required "to have canvassed the employees to ascertain why or how they voted...." *Celanese Corporation of America* v. *NLRB*, *supra*, 291 F. 2d at 226. "No one knows the importance of the . . . plan to the voting employees. Lacking the means of dependable subjective investigation, the law requires that no untruth be spoken in regard to the plan . . . ." *Allis-Chalmers Manufacturing Company* v. *NLRB*, *supra*, 261 F. 2d at 616. On the question of causal relationship, it is enough to render the election void that the misleading omission was material.

to rebut the respondents' showing. For this purpose, the Court remanded the case for a trial on the issue whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013. At one stroke, the court below thus stultified the broad purpose of disclosure distinctive to §14(a), and remitted the investing public to whatever protections may be afforded by the common law actions for fraud and deceit. The unique function of a disclosure statute, dispensing with any inquiry into actual deception, is nullified. Contrary to the command of this Court in *Borak,* the violation of §14(a) gives rise to no remedy in the Seventh Circuit's view; the cause of action is complete only when the requisite of the action for common law deceit is satisfied by determining "whether the injured party relied on the misrepresentation." A. 1013, n. 10.

III. THE SEVENTH CIRCUIT'S RELIANCE-CAUSATION TEST REQUIRES UNWORKABLE SPECULATIVE INQUIRY INTO SHAREHOLDER MENTAL PROCESSES IN VIOLATION OF THE POLICY OF THE ACT

Even if Congress had not eliminated reliance (and derivative tests of causation) from the civil remedy for violation of a compulsory disclosure statute, no such requirement could feasibly be interposed for determination upon evidence produced at a trial. When the corporate action in question "results not from the deceit practiced on [the plaintiff] alone but rather from the deceit practiced on the stockholders as a group" (*Borak,* 377 U.S. at 432), the machinery of a judicial trial can provide no answer to the question whether the collective mass decision was controlled in fact by the truth and not the false-

hood in the proxy statement, or would have been different if undisclosed information had been revealed. With direct factual resolution impossible, any requirement of reliance or of related causal standards, if otherwise proper, must be satisfied by the intended, reasonable, and probable effect of the violation, and by its natural tendency, not by proof of actual mental processes.

Two courts below have found that the respondents' nondisclosure of the directors' conflict-of-interest position constituted the omission of a "material fact necessary in order to make the statements therein [the directors' pro-merger advice] not false or misleading", "at the time and in the light of the circumstances under which" the advice was given, in violation of Rule 14a-9. The finding of materiality means that " 'a *reasonable* man would attach importance [to such a fact] in determining his choice of action in the transaction' " and that the nondisclosure " 'in reasonable and objective contemplation' . . . may affect the desire of investors to buy, sell, or hold the company's securities.'"[16] Respondents' pro-merger recommendation itself establishes that they "intended that action be taken in reliance on the claimed disinterestedness of the [advice] and its exclusive concern for the [shareholders'] interests." *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-93, n. 39 (1963). This intended, reasonable, and probable effect on the minds of the investors did not warrant holding the perpetrators liable for the expected consequences, in the opinion of the court below, without a further finding, as a matter of fact, that the investors' minds were actually changed.

---

[16] *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied sub nom. Coates* v. *SEC* and *Kline* v. *SEC*, 89 S.Ct. 1454 (April 21, 1969).

A. The Seventh Circuit's "But For" Test Is More Restrictive Than Common Law Requirements

The Seventh Circuit's opinion ascribes its unworkable causation test to the "corresponding" question drawn from "common law fraud." A. 1013, n. 10. Even if, stultifying the broad remedial purposes of the federal securities law, it were proper to "read the statute, in effect, as confined by traditional common-law concepts of fraud and deceit," (*SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 185 n. 6), still even the common law would reject such a narrow test. The Seventh Circuit's rationale was dealt with by Mr. Justice Cardozo in *DeCicco* v. *Schweizer*, 221 N.Y. 431, 438, 117 N.E. 807, 810 (1917), in characteristic phrases which expose the fallacy: "The springs of conduct are subtle and varied. One who meddles with them must not insist upon too nice a measure of proof that the spring which he released was effective to the exclusion of all others." It follows that when truth and falsehood are mingled, the lie need not be the sole inducing cause of the plaintiff's act,[17] and that the requisite

[17] *Cf. Longwith* v. *Butler*, 8 Ill. 32 (1845), where the Illinois Supreme Court, in dealing with common law fraud, answered the defendants' argument that "the complainant has not proved that the persons whom the purchaser induced not to bid for the land, were actually influenced in their actions by the inducement so held out to them," by stating at page 43: "It is sufficient to taint this transaction and avoid its effects, that the purchasers here have sown the seeds of evil. It is not for them to say that they have not taken root and borne their legitimate friut. . . . Human action hardly ever spring from one cause alone, but most generally from a combination of causes. But few men can trace their actions with certainty, to a preponderating motive. At the time they act, they have often become unconscious of many of the influences which indeed produced the result, and it is but too common for human nature to beguile itself into the belief that the motive which produced the act, was proper and unobjectionable, and that other less innocent causes, though they presented them, exercised no influence."

causal relationship is not rebutted by showing that the plaintiff "would have acted as he did independently of the existence of the" fraud. *Cf. Peterson* v. *Greenville*, 373 U.S. 244, 248 (1963). This rudimentary principle of common law is exemplified in the RESTATEMENT OF RESTITUTION, under the heading "Causation and Materiality":

> "*Illustrations:*
>
> • • •
>
> 3. A misrepresents to B that a corporation, the shares of which he wishes to sell to B, has assets of $1,000,000, has earned an average of 10 per cent. upon its capitalization for the past five years, and has made specified contracts with others. The last statement is untrue. B purchases the shares relying upon all these representations, although he would have made the purchase if the first two statements alone had been made. B is entitled to restitution." (RESTATEMENT, RESTITUTION *p.* 37, §9(2), *Comment (a), Illustration 3* (1936).)

Under the mechanistic "but for"[18] test of reliance-causation applied below, the RESTATEMENT'S facts would be repugnant and self-contradictory, since the Seventh Circuit would not tolerate a conclusion that the victim was "relying upon all these representations, although he would have made the purchase" without the misrepresentation. The Seventh Circuit's demand for "causation in a strictly mathematical sense"[19] is thus more rigid than common law standards, where neither reliance nor causation is disproved by the fact that the victim would have taken the same action without the fraud. Surely Congress' reme-

---

[18] A.1013, n. 10.

[19] *Globus, Inc.* v. *Jaroff*, 271 F.Supp. 378, 381 (S.D.N.Y. 1967). The prerequisites to plaintiff's summary judgment enumerated in that opinion are here established without genuine controversy by respondents' admissions.

dial objective is at least no more demanding than the common law, and is satisfied when the misleading statement is part of a series of representations, all material, influential, and contributing in undiscernible degree to a single, inseparable act.[20]

B. Since Subjective Inquiry Into Stockholders' Mental Processes Is Impracticable, The Intended, Reasonable, and Probable Tendency of the Proxy Statement Controls

Although neither causation nor reliance, if required, would be disproved by a finding "that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found" (A. 1013), the court below remanded the case for a trial on that issue alone. The opinion eschews direct resolution of that question, however, conceding, "Reliance by thousands of individuals, as here, can scarcely be inquired into." A. 1013, n. 10. In this holding, at least, the Court of Appeals

---

[20] In *Laurenzano* v. *Einbender*, 264 F. Supp. 356, 361 (E.D.N.Y. 1966), the District Court rejected a "but for" test and found causation "[a]lthough the proxy solicitation was not a necessary or indispensable ingredient of the execution of the transactions. . . ." Such a "but for" test, applied to the *proxy solicitation*, not to the specific misstatement or omission contained, had been employed in *Barnett* v. *Anaconda Company*, 238 F. Supp. 766 (S.D. N.Y. 1965), to support a conclusion of no causation when the votes produced by the proxy solicitation were unnecessary to approval of the corporate action. That conflict of authority need not be resolved here, since in this case the minority shareholders' votes were essential to approval of the merger, and the merger could not have been approved "but for" the proxy solicitation. *Cf. Klopot* v. *Northrup*, 131 Conn. 14, 37 A.2d 700 (1944). No authority has been found which would support the Seventh Circuit's "but for" test as applied to the specific misstatement or omission.

was eminently correct. Voters themselves are unaware of the factors which influenced their choice, as has been repeatedly demonstrated not only in corporate elections[21] but in political[22] and labor[23] electoral processes as well.

In order "to provide such remedies as are necessary to make effective the congressional purpose", (*J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433), within the practical realities of the judicial process, the law is satisfied when the intended, reasonable, and probable effect of the misleading communication is to influence the stockholders to vote in a particular way, and when that intended, reasonable, and probable vote is cast in fact. This practical reasoning is exemplified by the District Court's opinion in *Union Pacific R. Co.* v. *Chicago and North Western Ry. Co.*, 226 F. Supp. 400, 411 (N.D.Ill. 1964):

> "It cannot be said with indisputable certainty that the use of the [misleading proxy material] necessarily defeated an otherwise favorable vote on the Union Pacific merger. . . .
>
> To require direct proof that the votes of a critical number of shares were changed by the [misleading

---

[21] ARANOW AND EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 510 (2d ed. 1968).

[22] CAMPBELL, CONVERSE, MILLER & STOKES, THE AMERICAN VOTER 523 (1960): "The explanations offered for an electoral result are astonishingly varied; they depend typically on the slenderest evidence, and disagreements are commonplace even among knowledgeable observers."

[23] BOK, *The Regulation of Campaign Tactics in Representation Elections Under the National Labor Relations Act*, 78 HARV. L. REV. 38, 40 n. 8 (1964): "[V]ery cumbersome investigations would have to be made in a very large number of cases. Moreover, the testimony received would often be unreliable . . . because voters may be largely unaware of the true reasons for their ultimate decision. . . ."

proxy material], and more precisely by its misleading portions, would raise insuperable obstacles to relief and nullify the legislative purpose. The present state of understanding of human mental processes does not enable us to weigh with exactitude the components of decision or to determine scientifically that any particular element was controlling. The law does not ask more than human knowledge can supply. The substantial probability of a different result if improper evidence had not been submitted suffices to set aside the vote of a jury. The same standard applies in reason to the stockholders' vote."

In keeping with the limits of practicality, the application of this standard does not—and did not in that case—depend upon "any evidence introduced regarding either probability or certainty that the vote was affected. . . . It is difficult to see how the question could be otherwise decided . . ." upon an evidentiary foundation. JENNINGS AND MARSH, SECURITIES REGULATION: CASES AND MATERIALS 1001 (2d ed. 1968). Other leading commentators agree that the tendency—not the fact of actual deception—must control. "In recognition of this fact, judges and administrators have agreed that actual interference with an election need not be shown to establish a violation of the law; it is enough that the conduct in question *tends* to have these effects." BOK, *The Regulation of Campaign Tactics in Representation Elections Under the National Labor Relations Act*, 78 HARV. L. REV. 38, 42 (1964).[24] "When the complaint is of fraud in the solicitation of proxies, it should not be necessary to show that any stockholders were actually deceived if the misrepresentations are sufficiently material that they *might* have voted differently."

---

[24] Citing *Republic Aviation Corp.* v. *NLRB*, 324 U.S. 793, 798-800 (1945). *Cf. NLRB* v. *Donnelly Garment Co.*, 330 U.S. 219, 231 (1947).

Loss, *Private Actions Under the Proxy Rules*, 73 HARV. L. REV. 1041, 1074 n. 131 (1961).

The impracticality of any attempt to hold a trial to inquire into the stockholders' mental processes is compounded where, as here, the defect in the proxy statement is an omission. Unlike an affirmative misstatement, an omission would require not a determination of what, in fact, occurred in the investors' minds, but a hypothetical conjecture into what might have occurred—but did not—had the fact been disclosed. Since no competent evidence could be introduced to aid the decision, any requirement of "reliance" in cases of nondisclosure could be "little more than a formal requirement." *Mader* v. *Armel*, 402 F. 2d 158, 162-63 (6th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969); 3 Loss, SECURITIES REGULATION 1765-66 (2d ed. 1961). No trial of such a hypothetical "fact" could be conducted.

In other fields, this Court has flatly forbidden the sort of exculpatory speculation countenanced by the court below. In *American United Mutual Life Insurance Company* v. *Avon Park*, 311 U.S. 138, 144 (1940), the Court said:

> "Where it does not affirmatively appear that full and complete disclosure of the [directors' adverse] interests was made to the [shareholders] when their assents were solicited, it cannot be said that those assents were fairly obtained. Cf. *Rogers* v. *Guaranty Trust Co.*, 288 U.S. 123, 143."

In the passage cited from *Rogers*, Chief Justice Stone, dissenting, said:

> "We need not conjecture whether, if the directors had had the hardihood to disclose [their adverse in-

terest] in advance . . . the stockholders would nevertheless have given their approval."[25]

Refusal to permit speculation to relieve corporate insiders of the consequences of a breach of the duty imposed by Section 14(a) is singularly necessary where, as here, the breach consists of a violation of the historic fiduciary duty of insiders fully and fairly to disclose to the shareholders the directors' own tainted loyalty. Inevitably, the most influential factor in a shareholder's decision will be the recommendation and advice of his board of directors when unopposed and believed to be unbiased. In connection with this critical factor, the courts below found a material nondisclosure in violation of the law, and found that the consequently unlawful proxy solicitation was essential to approval of the merger. The courts below also agreed that any attempt to probe into the mental processes connecting the nondisclosure with the favorable vote, through evidence introduced at a trial, would be impractical and feckless. In this situation, there is no feasible alternative to—and no permissible escape from—the logical inference which led Congress to declare the proxy solicitation unlawful. Congress having outlawed deceptive proxy statements because of their tendency to mislead the shareholders, it is not for a court to reevaluate the legislative findings or to draw different inferences on its own appraisal of the probabilities. See *Katzenbach* v. *McClung*, 379 U.S. 294, 303-05 (1964).

---

[25] See also *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968). There the Court set aside the action of an arbitration board for nondisclosure of financial relations between a member of the panel and one of the parties, over the argument that the potential conflict of interest could not have affected the outcome or "caused" the award since the decision was rendered unanimously by a three-man panel of arbitrators, and since the complaining party's attorney had conceded that probably he would have taken no action to exclude the challenged arbitrator if the facts had been disclosed.

IV. A JUDICIAL RECONSTRUCTION OF THE STOCKHOLDERS' VOTES CANNOT BE PREDICATED ON THE FAIRNESS OF THE MERGER

Rejecting the congressional inference, and the consequent principle that insiders "cannot accomplish by deception what they might have accomplished honestly and then be heard to say that the deception was not the cause", (*Eagle* v. *Horvath*, 241 F. Supp. 341, 344 (S.D. N.Y. 1965)), the Seventh Circuit insisted upon a trial of the abstract and supposititious issue whether "the merger would have received a sufficient vote even if the proxy statement had not been misleading...." A. 1013. Bowing to reality, the opinion eschews a direct approach to this issue as impractical and, compounding the error, resorts instead to indirect conjecture to determine circuitously the shareholders' hypothetical state of mind, based upon a presumption that minority stockholders would authorize any merger, without unlawful inducement, if its terms "were in fact fair and equitable" to them.[26] A. 1012. The presumption is both insupportable as a matter of fact and impermissible as a matter of law.

---

[26] The Seventh Circuit's brand of logic, rigorously pursued to it conclusion, would lead not to the question whether the merger's terms were "fair and equitable" in the objective sense of a relatively equal bargain, but rather to the question whether the offered deal was favorable enough — fair or not — to garner sufficient votes to carry the merger. The lowest price acceptable to the smallest percentage of shareholders needed to approve the merger would therefore tip the scales of probabilities, and, in the Seventh Circuit's view, immunize the merger, no matter how much higher the "fair" price, objectively determined might be. Petitioners, of course, dispute the suggestion that the terms of merger could be called "fair" by any standard, but take the position that litigation of any such speculative question is irrelevant to their rights.

A. The Seventh Circuit's Conclusive Presumption of Shareholder Approval If the Merger Were Fair Is Unfounded in Fact

On the factual side, it simply defies experience to presume conclusively[27] that the shareholders of every corporation are so eager to merge that they hold out the standing invitation: No fair offer refused. Here the minority stockholders were called upon to decide whether they chose to relinquish their position as common share owners of a half interest in an automotive parts business and to accept instead the tendered status of preferred shareholders with a one-fourth interest in a new and untried conglomerate heavily involved in the manufacture of printing machines. As investors, not speculators, their interest was not confined to tomorrow's relative market quotations for the securities. They were entitled to appraise the investment prospects for themselves, and to vote to reject the merger offer, no matter how fair or beneficial it might appear to a financial expert or to a court.

---

[27] While the court below suggests that it may be possible for the respondents "to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found" (A. 1013) by proving the merger to be fair and equitable, the court does not indicate what proof would then be required of petitioners to rebut the respondents' showing. It is obvious, however, that petitioners would be required to prove what actually happened, a virtually impossible requirement and one much more stringent than the "preponderance-of-probabilities" requirement imposed upon respondents. Whether or not the court would hold testimony from each of "thousands of individuals" (A. 1013, n. 10) to be admissible, the presumption of approval created by *prima facie* proof of fairness would as a practical matter be a conclusive and irrebuttable presumption.

The novel principles of causation announced by the court below would apply equally to a vote by proxy on the election of directors, and would lead to the equally illogical conclusion that fraud warrants no relief so long as the winner is qualified to hold office. The Seventh Circuit's notion that the "merits of the terms of merger" would support a conclusion that the outcome of the vote was not affected by the material nondisclosure cannot survive this Court's decision in *Wirtz* v. *Hotel, Motel and Club Employees Union*, 391 U.S. 492 (1968). There the question was not the elusive influence of nondisclosure on voters' minds, but the objective effect of defective union by-laws which excluded from the ballot certain candidates for union office. Anticipating the Seventh Circuit's approach, the lower courts had concluded that the election should not be set aside since the exclusion could not have affected the outcome of the voting. Examining the "merits" of the issue, they found that the victors were incumbents and had demonstrated enlightened and aggressive leadership, that there was no substantial grievance against them, that no disqualified nominee was a proven vote-getter, that the incumbents had the overwhelming advantage of a full slate of candidates, and that the insurgents who did appear on the ballot had lost by a margin of seven to one.

This Court reversed, and directed that, as a matter of law, the election must be set aside, since evidence tending to show the "merits" of the issue had no probative value to discharge the defendants' burden of proving that their violation did not affect the result of the voting. "None of the factors relied on is tangible evidence against the reasonable possibility that [the violation] did affect the outcome. Nothing in them necessarily contradicts the logical inference" that the result might have been

affected. "In short, the considerations relied on by the court are pure conjecture, not evidence." 391 U.S. at 508.

The sole justification offered by the Court of Appeals for reversing the finding of liability is to allow such a trial of "pure conjecture, not evidence" on this rejected theory that the merits control causation: "The material offered by defendants on the merits of the terms of merger suggests that it may be possible for them to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found." A.1013. Under this Court's teaching in *Wirtz*, the supposed evidence[28] would have no probative value, and the trial would be fatuous.

Applicable here is this Court's observation in *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 366, note 18 (1963): "[a] substantive inquiry after the fact cannot possibly succeed in accurately ascertaining retrospectively what the outcome would have been had [the material nondisclosure not occurred]. The conditioning of relief for the [statutory] breach on a finding that a concomitant substantive breach occurred might well, therefore, result in an ultimate wrongful denial of recovery. . . ."

---

[28] The only merit found by the Court of Appeals in the respondents' affidavits in response to the summary judgment motion was confined to "evidentiary material tending to show that the merger has merit and that the terms were fair and equitable to the minority shareholders". A.1012. Such a showing would neither discharge their burden of proof at trial, nor their burden on the motion to "set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e), as amended 1963. *See* Advisory Committee Note, 31 F.R.D. 648 (1962); *First National Bank* v. *Cities Service*, 391 U.S. 253, 290-91 (1968).

B. The Decision Below Stultifies the Congressional Purpose by Disenfranchising the Stockholders and Substituting a Judicial Appraisal of the Merger's Merits for Their Actual and Informed Vote

The Seventh Circuit's presumption that stockholders would approve any fair merger is unfounded in fact, but more importantly as a matter of law it is utterly destructive of the salutary purpose of Section 14(a). Congress enacted the statute in the "belief that '[f]air corporate suffrage is an important right that should attach to every 'equity security bought on a public exchange'" and to protect "'the free exercise of the voting rights of stockholders.'" *Borak*, 377 U.S. at 431. The decision below defies this remedial objective by completely disenfranchising the stockholders and substituting for their actual and informed vote a judicial appraisal of the merger's merits. The stockholder's right to cast an informed vote, declared and guarded by Congress, is effectively circumvented, along with his right to decide for himself whether the merger is fair, beneficial, and meritorious—and to reject it even so if he finds it undesirable for any good or bad reason. In effect, the court casts his vote for him, upon an after-the-fact prediction of how he would have voted if he had known the facts. The fraud which corrupted his right of suffrage is condoned "for his own good." By the alchemy of the Seventh Circuit's novel causation test, the statute guaranteeing free and informed voting in the corporate enterprise is transformed into a mere prohibition against unfair mergers, a prohibition which "would have been superfluous in view of the fiduciary standard to which [the corporate managers] were already bound under settled principles of equity." *Wolf* v. *Weinstein*, 372 U.S. 633, 645 (1963).

Once the congressional objective is clearly perceived, causation appears in proper perspective. Regardless of the probable outcome of the voting, suffrage has its own values: participatory democracy, the competition of conflicting opinion, and responsibility to the minority. Judge Dooling correctly discerned the congressional purpose in *Laurenzano* v. *Einbender*, 264 F. Supp. 356, 362 (E.D. N.Y. 1966):

> "The vote is not legally predetermined simply because it seems practically predictable. . . . If proxies are solicited, the stockholders have a statutory right to a truthful proxy statement. Misleading proxy material impeaches the validity of the meeting, its efficacy as a meeting. A majority stock holding cannot legitimate a meeting based on misleading information by reference to its possession of votes that would suffice to end debate. The misleading proxy material deprives the meeting, and the majority stockholder, of the expressions of view and the votes that would have ensued upon truthful disclosure; it is not legally possible to decide what legal consequences flow from the informational defects in the meeting by asserting that the meeting would have ended in the same resolutions no matter what the views or votes of the minority. *That is not necessarily the fact and it cannot be the resolving principle of law.*" (Emphasis added).

In public governmental elections as well as in corporate voting, the Seventh Circuit's decision would apply with as much logic to immunize interference with voting rights so long as "a preponderance of probabilities" would favor the same outcome had fair suffrage not been denied. In that field, the Fifth Circuit exemplified the necessary approach to the causal relationship between the corrupting force and the election results, in *Bell* v. *Southwell*, 376

F.2d 659 (5th Cir. 1967). There the plaintiff, an unsuccessful candidate for Justice of the Peace, sought to invalidate the election because certain voters had been intimidated in the exercise of their voting rights. The District Judge had denied relief because of the drastic and "staggering" implications of setting aside a public election, and because there was "no way to tell whether the result would have been different" in the absence of discrimination, and hence "no harm or injury is shown." The Fifth Circuit, forthrightly and realistically, rejected these reasons. The policy of freedom of elections, it held, does not permit denial of relief for "inability to demonstrate that the outcome would have been different." 376 F.2d at 662.

Congress has left it to the stockholders—not management or the courts—to decide whether the merger should go forward. In the exercise of the "fair corporate suffrage" thus conferred, they may choose to reject a fair and beneficial merger or to approve an unwise proposal. Whether a merger is good or bad is irrelevant; the stockholders have a right to be wrong. This Court declared in *Borak*, "The purpose of §14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation. . . . It was intended to 'control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which . . . [had] frustrated the free exercise of the voting rights of stockholders.'" 377 U.S. at 431. A "federal cause of action for rescission or damages to a corporate stockholder" is created by a violation of this command. *Id.*, at 428. Having found an actual violation consisting in "deceptive or inadequate disclosure," the court below ignores its "duty . . . to provide such remedies as are necessary to make effective the congressional purpose." *Id.*, at 433.

Instead, the court wipes the slate clean, absolving the violator of any consequences for his actual and established wrongdoing, and offers him a free and fresh start with the chance to persuade a judge that the merger has merit. The fraudulent insider need not risk submitting his plan, honestly and openly, to the shareholders for their fair and informed consideration. He avoids that hurdle by resorting to fraud, and is better off for having violated the law since at worst, if the fraud is discovered, he will be called upon to show to a court that his scheme has merit and is "fair and equitable to the minority shareholders." If allowed to stand, the Seventh Circuit's ruling "would place a premium on concealment [of material facts] and thereby jeopardize the salutary policies of the statute." *Wolf* v. *Weinstein*, 372 U.S. 633, 654 (1963).

C. The Seventh Circuit's Decision Renders the Act Superfluous by Making Liability Turn upon the Substantive Fairness of the Merger

The Seventh Circuit does not suggest that unfairness of the merger is an independent prerequisite to liability, but the sum total of its holding is the functional equivalent of such a ruling. Since a showing that the merger is "fair and equitable to the minority shareholders" would support a finding of no "causal relationship" under that court's opinion, the practical effect is to condition the outcome of the case on a determination of fairness, which is what respondents urged below. The court thus adopts by indirection the position argued to this Court, and rejected, in *Borak*, that "a deficient proxy statement followed by a beneficial merger gives rise to no cause of action, but a lawful proxy statement followed by a fraudulent merger is actionable. In short, the violation of §14(a) has no crucial bearing on the main thrust of the claim." Brief of Petitioners

Harry G. Barr *et al.* at 10, *J. I. Case* v. *Borak*, 377 U.S. 426 (1964). That reading of federal law was rejected by this Court in *Borak*, since if it would "attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated." 377 U.S. at 435.

The decision below transforms the broad prophylactic prohibition against seeking stockholder authorization through misrepresentation into a narrow—and superfluous—condemnation of unfair transactions. On that approach, the disclosure requirements of the federal securities laws add precisely nothing, since unfair transactions, characterized as constructive fraud, have always been actionable in state courts. Because the cause of action in this view would not turn upon federal law but would arise under the law of the state, the Sixth Circuit had held in *Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201 (6th Cir. 1961), that the federal courts have no jurisdiction, absent diversity, to entertain suits for relief against a consummated merger under Section 14(a). *Borak* overruled that decision (377 U.S. at 434), and with it the notion that liability for a violation of the proxy rules is dependent upon the merits of the merger in its substantive terms.

That the Seventh Circuit misconceived the thrust of *Borak* is confirmed by *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969), decided after the Seventh Circuit opinion was handed down. *National Securities* reaffirms that in forbidding misleading proxy solicitation for a merger, "the Federal Government is attempting to protect security holders from fraudulent misrepresentations" and "is asking . . . that . . . companies speak the truth when talking to their shareholders." The Court reasoned from this purpose that in an enforcement suit "[n]o question of the legality or illegality of the merger, standing alone, was raised", since

under the federal securities laws, "[t]he gravamen of the complaint was the misrepresentation, not the merger." 393 U.S. at 462-3. In short, the merits of the merger and its fairness are irrelevant to the violation.

Congress' objective was not to prohibit transactions which, on their merits, are unfair or unworthy; its condemnation encompasses all transactions infected by their promoters with the virus of nondisclosure. Full disclosure is required not to assure fairness, but because it is "essential to maintain public confidence in the securities industry and to preserve the economic health of the country." *SEC* v. *Capital Gains Research Bureau Inc.*, 375 U.S. 180, 201 (1963). "Section 14(a), (c) exacts candor of disclosure, not fairness of substantive terms. . . ." *Laurenzano* v. *Einbender*, 264 F. Supp. 356, 361 (E.D.N.Y. 1966). "The fundamental aim of the [disclosure] requirement was to provide information, and not to shield the public from ventures deemed to be of dubious merit." The Wheat Report, *supra* n. 5, at 49.

This Court again rejected unfairness as a prerequisite to liability for nondisclosure in *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963). There the lower courts had denied relief against advice to investors, tainted by an undisclosed conflict of interest, because "no actual loss of money to clients" had been shown (375 U.S. at 184), and because it did not appear that "the investment advice was unsound" (306 F. 2d 606, 608), or that there was "actual injury to clients". 375 U.S. at 186. This Court did not pause for conjecture on whether the recommendations might still have been followed if the conflict of interest had been disclosed. The reversal was summary: "It would defeat the manifest purpose of the . . . Act . . . for us to hold, therefore, that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit,' intended to require proof of intent to injure and actual injury to

clients." 375 U.S. at 192. ". . . Congress intended a broad remedial construction of the Act which would encompass nondisclosure of material facts," not one which turns on "fraud and deceit in their technical sense", including "intent to injure and actual injury. . . ." 375 U.S. at 186, 185, 195.

D. The Seventh Circuit's Ruling Makes the Statutory Right More Restrictive Than Traditional Non-Statutory Restitution, Where Fairness Is No Defense.

Under the Seventh Circuit's restrictive interpretation, the defrauded investor is not only unaided by the congressional enactment; he is actually handicapped by the statute, and denied relief traditionally afforded in a non-statutory suit for fraud. Apart from statute, it has long been settled that misrepresentation in a security transaction entitles the misled buyer or seller to rescind the transaction and to obtain restitution of the consideration he gave without regard to the fairness of the exchange, since "in a court of equity it is the fraud, and not the damages, which entitle him to relief." *Stern* v. *Kirby Lumber Co.*, 134 Fed. 509, 510 (S.D.N.Y. 1904). *See also, e.g., King* v. *Lamborn*, 186 Fed. 21, 29 (9th Cir. 1911); *Mather* v. *Barnes*, 146 Fed. 1000, 1004 (W.D. Pa. 1906). The operative effect of the Seventh Circuit's ruling is also more restrictive than the judge-made principles specifically applicable to fiduciary transactions involving a potential conflict of interest. Prevailing equitable doctrine holds that if the conflict of interest has been fully disclosed, the transaction may survive if the fiduciary sustains his burden of proving its fairness. But without full disclosure, on the other hand, the transaction must be set aside regardless of fairness. *See* RESTATEMENT (SECOND) TRUSTS §216(3), pp. 499, 505; §170(2), pp. 364, 373; *Thruston* v. *Nashville & American Trust Co.*, 32 F. Supp.

929 (M.D. Tenn. 1940). The ruling below inverts this rule, in practical effect, to immunize the undisclosed conflict of interest if the transaction is proved to be fair.

A decent regard for legislative history demands that Section 14(a) should be treated as no worse than superfluous. If, despite its broad remedial purpose, the statute is to be read as adding nothing to the investor's right to be relieved of fraudulent transactions found to be fair in their terms, at least the statute should not *detract* from his rights, to deprive the investor of the protections afforded by traditional equitable rules of fraud. Upon this modest proposition, the District Court in *Gerstle* v. *Gamble-Skogmo, Inc.*, C.C.H. Fed. Sec. L. Rep. ¶92,367, at p. 97,749-50 (E.D.N.Y. March 7, 1969), ruled, by analogy to the equitable remedy of rescission and restitution, that the fairness or merit of a merger is no defense to a civil action for nondisclosure in the proxy statement. The Court said:

> "Assuming, *arguendo,* there was a failure to disclose a material fact in the proxy statement, defendant claims that since the plan of merger was fair the plaintiffs suffered no damages. . . . When a seller is induced to sell his property by means of a statement which he subsequently learns is false, the fact that the sales price was fair at the time is irrelevant. The seller may thereafter maintain an action in equity for a rescission of the contract and an accounting of the proceeds and the ensuing profits. If the property cannot be returned, the plaintiff is entitled to restitution. *Falk* v. *Hoffman,* 233 N.Y. 199, 135 N.E. 243 (1922). *Janigan* v. *Taylor, supra* [344 F.2d 781 (1st Cir. 1965), *cert. denied,* 382 U.S. 879 (1965)] and *Kardon* v. *National Gypsum Co.,* 73 F. Supp. 798, *modified* 83 F. Supp. 613 (E.D.Pa. 1947), decided under §10(b), have both held that damages at the time of the sale of the stock is not an element

of the cause of action if there has been a violation of the disclosure requirement. In this case the stockholders were defrauded by voting for a merger without vital information withheld by insiders. . . .

. . . The purpose of §14(a) was to prevent such frustration of stockholders (H. R. REP. No. 1383, 73d Cong., 2d Sess. 13, 14). The exercise of this right cannot be defeated by the mere promulgation of a fair plan in a merger proceeding."

V. THE DECISION BELOW STIFLES PRIVATE ENFORCEMENT SUITS, A NECESSARY SUPPLEMENT TO COMMISSION ACTION IN ENFORCING THE ACT, BY RAISING INSUPERABLE OBSTACLES TO RELIEF.

In *Borak* this Court observed (377 U.S. at 432):

"Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in anti-trust treble damage litigation, the possibility of *civil damages* or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements." (Emphasis added).

This "necessary supplement" is virtually destroyed as an "effective weapon" by the holding below. As the Court of Appeals pointed out (A. 1012), petitioners own, between them, only 5/100 of 1% of the Autolite shares. They are the "little investors" who need the greatest possible protection.[29] Yet the court below would compel

---

[29] *Surowitz* v. *Hilton Hotels Corporation*, 383 U.S. 363, 371 (1966): [D]erivative suits have played a rather important role in protecting shareholders of corporations from the designing schemes and wiles of insiders who are willing to betray their company's interest in order to enrich themselves. And it is not easy to conceive of anyone more in need of protection against such schemes than little investors like Mrs. Surowitz." See also, *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967).

the small shareholder, even after he has established that the proxy solicitation was unlawful, to litigate the merits and fairness of the merger as a condition precedent to *any* relief. No small investor could afford to rebut the array of expert witnesses produced by the corporation, in discharge of its burden of proof on fairness, by himself engaging a competing array of expert financial witnesses, causing exhaustive audits and investigations of the books and records of huge corporations, by the taking of lengthy depositions, and by financing such items as the court reporting of the inevitably protracted trial. If the time, expense, and staff requirements of such an undertaking are not available to the SEC to "permit an independent examination of the facts set out in the proxy material" (*Borak*, 377 U.S. at 432), obviously the small investor, whose total stake may be less than such costs, is never in a position to match the corporate resources available to management in a full-dress trial to determine the fairness of a merger.

This Court recognized the danger of chilling private actions when it said in *Borak* (377 U.S. at 435):

> "[T]he hurdles that the victim might face (such as separate suits, as contemplated by *Dann* v. *Studebaker-Packard Corp.*, *supra*, security for expense statutes, bringing in all parties necessary for complete relief, etc.) might well prove insuperable to effective relief."

The Court of Appeals in this case assessed against petitioners all costs of that appeal, approximately $9,000 (A. 1000, 1015), on the theory that they had not yet estab-

lished liability.[30] Confronted with the prospect of such a cost bill, as a prelude to the cost of a trial on the merits and fairness of the merger, few, if any, investors could afford to litigate even the most outrageous Section 14(a) violation.

Merger litigation is not the only kind of enforcement action obstructed by the test of "causation" fashioned by the Court of Appeals, nor is the fairness or merit of a merger the only extraneous issue introduced. The lower court's rationale would extend equally to any factor which might, reasonably or unreasonably, be taken into account by an investor in making his decision, allowing the corporate insider, already found guilty of deception, to wage a defensive war of attrition by litigating everything that conceivably bears on the "probabilities" that honesty might have induced the same action by the victim: the qualifications of management, long-run prospects in the industry, tax consequences, the advice being offered by brokers and tipsters, the health of the national economy, etc.—all are potentially triable. Proxy statements for the election of directors, approval of stock-option plans, or the selection of auditors would be equally affected. Unconfined by anything in §14(a), the Seventh Circuit's ruling would also destroy the utility of actions under any other section of the securities laws, by demanding an exhaustive trial of speculation on whether the de-

---

[30] The District Court's entry of summary judgment on the issue of liability constituted the granting of a declaratory judgment that the proxies had "been obtained in violation of §14(a)", a part of the relief requested in the complaint. A.179-80. The Court of Appeals affirmed this conclusion. The proper consequence of this affirmance would impose costs on respondents. The court nonetheless entered a judgment of reversal, imposing $9,000 costs on the petitioners.

frauded 10(b) plaintiff, for example, might have been willing to buy or sell at the same price had there been no fraud or manipulation.[21] As a test of causation, not of standing to sue, the lower court requirements would apply to the SEC as well as to a private plaintiff, rendering public enforcement equally impotent.[22]

In the comparable field of anti-trust treble damage litigation, described in *Borak* (377 U.S. at 432) as serving the same enforcement function as private securities suits, this Court recently considered a claimed defense, like that sanctioned by the court below, that the defendant's violation did not cause the consequences complained of. The Court rejected that comparable defense with these applicable observations on the practicalities of private enforcement:

> "Normally, the impact of a single change in the relevant conditions cannot be measured after the fact . . . . [I]t is not unlikely that if the existence of the defense is generally confirmed, antitrust defendants will frequently seek to establish its applicability. Treble damage actions would often require additional long and complicated proceedings involv-

[21] *Cf.*, for example, *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968), *cert. denied sub. nom. Coates* v. *SEC* and *Kline* v. *SEC*, 89 S. Ct. 1454 (April 21, 1969).

[22] Applied to the SEC's suit which was before this Court in *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969), seeking under Rule 10b-5 to set aside the merger allegedly consummated through misleading proxy solicitation, the Seventh Circuit's ruling would require the SEC, upon remand from this Court, to commit its limited staff and resources to an extended trial on the fairness of a merger of insurance companies, involving issues foreign to its expertise, before the relief declared by this Court to be available can be considered or granted, if relief for the violation is not indeed foreclosed by the Seventh Circuit's fairness defense.

ing massive evidence and complicated theories.

". . . In consequence, those who violate the antitrust laws . . . would retain the fruits of their illegality because no one was available who would bring suit against them. Treble damage actions, the importance of which the Court has many times emphasized, would be substantially reduced in effectiveness." *Hanover Shoe, Inc.* v. *United Shoe Machinery Corp.*, 392 U.S. 481, 492, 493, 494 (1968).

The court below implied that petitioners were at fault for not moving to enjoin the merger. A. 1011. But that imputation overlooks the obstacles confronting the private litigant. Here the violation found by the courts below was not discovered until long after the meeting to approve the merger had been held, when it was pleaded in an amendment to the complaint. A. 163. In the nature of things, minority shareholders are not privy to insider information which management might omit from a proxy statement. Discovery of the truth will normally occur only after the transaction has been completed. See *Borak*, 377 U.S. at 432-33. Preliminary injunctions are also infeasible because of the requirement of obtaining an injunction bond at prohibitive cost, or of assuming the risk of damages in the event that permanent relief were ultimately denied. Enforcement through prospective suits, whether brought by the Commission[23] or by minority shareholders, falls far short of providing "such remedies as are necessary to make effective the congressional purpose." *Borak*, 377 U.S. at 433. It is for this very reason

[23] *SEC* v. *National Securities, Inc.*, 393 U. S. 453 (1969), exemplifies a situation likely to recur. The Commission's application for preliminary injunctive relief was denied by the District Court, erroneously as it turned out. Exigencies of time prevented review before consummation, and remitted the Commission to post-merger remedies.

that this Court found no "merit in the contention that . . . remedies are limited to prospective relief." 377 U.S. at 434. To withhold any remedy because the merger itself was not enjoined is to circumvent the holding of *Borak*.

VI. THE DECISION BELOW DEFEATS THE CONGRESSIONAL POLICY BY BARRING ANY RELIEF ONCE A MERGER, LATER FOUND TO BE FAIR, IS CONSUMMATED.

In light of the Court of Appeals' ruling that the undisputed findings would support prospective relief by way of injunction in advance of the meeting (A. 1011), its holding that there is no liability for the consummated merger rests alone upon its expressed reluctance "to unscramble a corporate transaction merely because a violation occurred." A. 1013-14. No question of "unscrambling", however, was properly before that court. The District Court had postponed for future hearing the question of its duty "to provide such remedies as are necessary to make effective the congressional purpose." *Borak*, 377 U.S. at 433. Petitioner's opportunity to be heard on the form of appropriate relief was foreclosed by respondents' interlocutory appeal, under Section 1292(b) of the Judicial Code,[44] from the District Court's ruling on the issue of liability alone.

At that point, petitioners were already entitled to final judgment in their favor, regardless of further developments. The District Court has entered a partial summary judgment "on the issue of liability" under Fed. R. Civ. P. 56(c), equivalent to "an order specifying the facts appearing without substantial controversy". Fed. R. Civ. P. 56(d). On the basis of those factual findings affirmed by the Court of Appeals, the petitioners would still be entitled to judg-

[44] 28 U.S.C. § 1292(b).

ment[35] if no further proceedings were permitted, or if they had rested their case. At this juncture, petitioners are entitled to have this six-year war of attrition brought to a close, and to a preliminary judgment assuring that further proceedings would be conducted at respondents' costs.

---

[35] At minimum, the right to the following remedies has already been established:

1. A declaratory judgment that the proxy statement was unlawful and that the vote authorizing the merger was illegally obtained. *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 427-28 (1964); *Dann* v. *Studebaker-Packard Corporation*, 288 F.2d 201, 216-17 (6th Cir. 1961). This relief was specifically demanded in the amended complaint. A. 179-80.

2. An injunction against violations in future proxy solicitations and transactions, in the light of past violations and a continuing nondisclosure. *SEC* v. *Okin*, 139 F.2d 87, 88 (2d Cir. 1943); *SEC* v. *Great American Industries, Inc.*, 407 F.2d 453, 458 (2d Cir. 1968), *cert. denied* 89 S.Ct. 1770 (May 26, 1969).

3. A judgment for nominal damages, to vindicate the petitioners' rights and to protect the integrity of the federal securities laws. *Sankin* v. *5410 Connecticut Avenue Corporation*, 281 F.Supp. 524, 567-70 (D.D.C. 1968) (carrying costs and attorney fees). See also *United States* v. *Mock*, 149 U.S. 273 (1893) (when a wrong but no damages are proved, plaintiff is entitled to judgment for nominal damages); *Dow* v. *Humbert*, 91 U.S. 294 (1876) (nominal damages and costs).

4. Costs and counsel fees for establishing and exposing this violation of the rights of the corporation and of the public interest. See *Sprague* v. *Ticonic National Bank*, 307 U.S. 161, 166-67 (1939); *Bakery and Confectionery Workers International Union of America* v. *Ratner*, 335 F.2d 691, 696 (D.C. Cir. 1964). See HORNSTEIN, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658 (1956).

5. An order directing respondents to render "an accounting of their unlawful gains". See *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969). *Cf. Bynum* v. *Baggett Transportation Company*, 228 F.2d 566, 573-74 (5th Cir. 1966).

Pre-empting the untendered issue of further relief, the Court of Appeals adds two unfounded assumptions: that dissolution is the only proper remedy for a consummated merger, and that dissolution is too harsh a remedy for the wrong. Neither assumption can survive examination.

This Court in *Borak* recognized the availability of a wide range of remedies for a merger consummated through a violation of the congressional disclosure requirements. "Damages" and "restitution" as well as "rescission" are mentioned by this Court. 377 U.S. at 428, 430, 433. Among these available remedies, it is the petitioners' right to choose which they will seek. See *The Fair* v. *Kohler Die & Specialty Company*, 228 U.S. 22 (1913). Although the determination of ultimate relief is not now presented for final decision, this Court is properly called upon to lay down the guidelines for further proceedings upon remand, to instruct the district courts in their "duty . . . to be alert to provide such remedies as are necessary to make effective the congressional purpose" (*Borak*, 377 U.S. at 433), and to eliminate "the difficulty of fashioning effective relief . . . before remanding the case so that the trial court may go forward with further proceedings without undue delay." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969).

A. Rescission by Dissolution Is an Available Remedy for a Consummated Merger.

There is nothing in the Acts of Congress or the pronouncements of this Court to support the Seventh Circuit's implication that "unscrambling" is unavailable as an alternate remedy for the material violation of the statute. Congress has declared the consequences of the violation: the merger is "void". Section 29(b), Securities Exchange Act of 1934, U.S.C. §78cc(b)(1934). Pursuing

the enumeration in *Borak* (377 U.S. at 428) of rescission as one appropriate remedy for a merger consummated through a violation of §14(a), this Court in *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 463-64 (1969), found "no reason to emasculate the securities laws by forbidding remedies which might prove to be essential" and ruled that "[o]n remand, the trial court may order a return to the *status quo ante* if it finds that course of action desirable, necessary, and otherwise lawful." These are the questions which the District Court was prepared to consider before the Court of Appeals reversed. In the present posture of the case, the desirability of divestiture remains to be determined, upon an investigation, among other things, of the degree of integration already achieved and the consequences of separation.

In any event, such a decree cannot now be removed from consideration simply because the merger has already been consummated. "Like restitution [divestiture] merely deprives a defendant of the gains from his wrongful conduct. It is an equitable remedy designed in the public interest to undo what could have been prevented had the defendants not outdistanced the [plaintiff] in their unlawful project." *Schine Chain Theatres, Inc.* v. *United States*, 334 U.S. 110, 128 (1948). See also *United States* v. *United Shoe Machinery Corporation*, 391 U.S. 244 (1968). Traditional limits on specific relief, applicable to purely private litigation, must yield when the purpose of giving private rights of action "was not merely to provide private relief, but was to serve as well the high purpose of enforcing the [federal] laws." *Zenith Radio Corporation* v. *Hazeltine Research, Inc.*, 89 S.Ct. 1562, 1580 (May 19, 1969).

In *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F.2d 357 (5th Cir. 1968), *cert. denied* 393 U.S. 913

(1968), the Fifth Circuit, joining the Second,[36] read the voiding provision of Section 29(b) as clear indication that Congress intended a "harsh remedy". There is no novelty in this, for courts of equity, including this Court, have long taught that effective enforcement of conflict-of-interest prohibitions, and particularly the related duty of disclosure, requires harsh remedies, including upsetting transactions in and of themselves completely fair and equitable. *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968); *Mosser* v. *Darrow*, 341 U.S. 267, 274-75 (1951); *Wolf* v. *Weinstein*, 372 U.S. 633, 654 (1963). The right to "disaffirm a contract which is infected by an illegal conflict of interest" is essential because of "this inherent difficulty in detecting corruption . . . ." *United States* v. *Mississippi Valley Generating Co.*, 364 U.S. 520, 565-66 (1961).[37]

B. The Remedy of Monetary Restitution Is Available to Redress a Consummated Merger Authorized Pursuant to Unlawful Proxy Solicitation.

If "unscrambling" should appear, after fair consideration, to be undesirable to the victims of the wrong or inappropriate for other reasons, monetary remedies stand ready as a substitute for specific reparation. Congress charged the courts "to be alert to provide such remedies

---

[36] *Goldstein* v. *Groesbeck*, 142 F.2d 422, 426 (2d Cir. 1944).

[37] In shaping a decree of divestiture in accordance with petitioners' prayer (A. 180), the trial court would properly allow for problems of timing and for the rights of third persons, and could include provisions "requiring the respondents to make an accounting of their unlawful gains, and readjusting the equities of the various respondents in whatever companies survived the decree." *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 456 (1969).

as are necessary to make effective the congressional purpose" (*Borak*, 377 U.S. at 433) in *all* cases, not to excuse violations entirely where "unscrambling" may not be warranted.

The equitable remedy of restitution, for the recovery of the value of the benefit conferred by the plaintiff, is traditionally available to afford money relief in transactions tainted by the non-disclosure of conflicting interests. See, *e.g.*, *National Bank & Loan Co.* v. *Petrie*, and *National Bank & Loan Co.* v. *Carr*, 189 U.S. 423 and 426 (1903) (companion cases, per Holmes, J.). This form of relief is specifically afforded by Congress and by this Court in actions under the securities laws. See *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282 (1940). The words of §27 of the 1934 Act, like the counterpart provisions of the 1933 Act, are "entirely sufficient to fashion a remedy to rescind a fraudulent sale [and to] secure restitution . . . ." *Borak*, 377 U.S. at 433. Since the unlawful transaction is treated as annulled when this remedy is invoked, restitution falls squarely within the intention of Congress in declaring the merger contract to be "void" when effected through a violation of the Act. Section 29(b), 15 U.S.C. §78cc(b). The consequent measure of monetary recovery is usually the return to the plaintiff of the value he relinquished, here the value of the corporate interest wrongfully appropriated by the defendant. Since the independent existence of their corporation was unlawfully extinguished, the petitioners are entitled to treat the transaction as an unlawful forced liquidation, and to recover for the minority stockholders their share of the worth of the corporate business at the price it would have brought in a sale, not to the controlling stockholders, but on the open market. *Cf. Sterling*

v. *Mayflower Hotel Corp.*, 33 Del. Ch. 20, 89 A.2d 862 (1952), affirmed 33 Del. Ch. 293, 93 A.2d 107 (1952).

On the other hand, petitioners may choose to accept the valuation placed upon these assets by the respondents themselves. In the opening portions of their proxy statement, they presented a *pro forma* balance sheet for the corporation resulting from the merger, to exemplify the "merit of the merger." A.39. In this document, respondents valued the interest to be acquired from the minority shareholders of Auto-Lite not at the cost of acquisition, but rather at the value attributed to it on Merganthaler's own books. The "minority interests in net assets" of Auto-Lite were represented on Merganthaler's books at $46,757,000 and, at the same time, the value of the preferred stock given in exchange at $34,457,000. The difference inured to the Merganthaler stockholders. In plain terms, respondents represented that the corporate equity acquired from the minority shareholders was worth $12,300,000 more than the minority shareholders were paid for it. A court of equity will hold respondents to their word.

Alternatively, the petitioners may choose, as the measure of money recovery in restitution, the minority's portion of any amounts received by respondents as proceeds of any subsequent sale of the corporate assets which they acquired in the unlawful merger, or the current appreciated value of the assets so acquired,[38] compelling respondents to disgorge their unlawful gains. A plaintiff with "the right to rescind the contract on the

[38] The measure of recovery may embrace the highest market price attained by the wrongfully acquired interest during a reasonable period after the acquisition. See RESTATEMENT, RESTITUTION §151, Comment (c) pp. 600-01 (1936).

ground of fraud [may] follow the property or its proceeds wherever they [can] be found . . . [requiring] that the proceeds of property obtained from it by fraud should be paid to it . . . ." *Montgomery* v. *Bucyrus Machine Works*, 92 U.S. 257, 258 (1875). No matter which of these various measures of recovery petitioners may choose, the trial court is empowered to compel restitution through the issuance of additional securities—partial shares of common stock, preferred stock, or debentures—as a substitute for the direct payment of cash.

None of these measures of recovery involves any inquiry into the fairness of the merger terms. In a different case, a plaintiff's interests might be better served by the measure of damages applicable in a traditional action at law for breach of contract or for the tort of deceit. By bringing such a suit, the plaintiff would ask to be put in the position he would have occupied if the merger had been "fair and equitable" to the minority shareholders (A.31), as it was warranted, and tortiously misrepresented, to be. This expectancy measure of recovery would require a determination of the "fair" exchange, and would involve full litigation of the relative values of two giant corporations, appraised by assets, good will, going concern, market prices, earning ratios, and other evaluation standards, to measure the departure from the limits of legitimate differences in business judgment. The burdens of such a trial would ordinarily prove insuperable, however, for the reasons considered above at pages 56-58 of this Brief. The usual equitable remedy of restitution, by contrast, is unimpeded by any impracticable comparison of values, since it is unrelated to the fraudulent bargain as made. These elementary principles were stated by Mr. Justice Holmes in *National Bank and Loan Co.* v. *Petrie*, 189 U.S. 423, 424-25 (1903):

"The declaration goes upon a rescission of the contract. . . . The right not to be led by fraud to change one's situation is anterior to and independent of the contract. . . . Its usual consequence is that, as between the parties, the one who is defrauded has a right, if possible, to be restored to his former position. . . . [The] fraudulent party, who otherwise might have been allowed to disclaim any different obligation from that with which the other had been content, has lost his right to object, because he has brought about the other's consent by wrong. . . . Here the attempt is to recover outside of it, treating it as set aside. An action for damages caused by fraudulent representations which induced a contract affirms the contract and relies upon it . . . and therefore may be subject to the same defenses as an action brought directly upon the contract . . .[b]ut [not] when a right is claimed to repudiate it. . . ."[9]

Here the petitioners have repudiated the merger, asking for "appropriate orders setting [it] aside" and for an order directing respondents to account to the corporation for the damages sustained by reason of the invalid transfer of corporate assets. A. 180. They do not ask to *enforce* the merger agreement, but to be put in the position they would have occupied if no unlawful merger had been effected. Their right to that relief, unobstructed by any inquiry into "fairness", is "necessary to make effective the congressional purpose". *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433 (1963); *Gerstle* v. *Gamble-Skogmo, Inc.*,

[9] In the companion case, Mr. Justice Holmes upheld the remedy of restitution where the fraud consisted in nondisclosure of the fact that the plaintiff's "confidential adviser" was acting also as agent for the seller, and "that he was on both sides of the transaction and interested against her." *National Bank & Loan Co.* v. *Carr*, 189 U.S. 426 (1903).

C.C.H. Fed. Sec. L. Rep. ¶92,367 (E.D.N.Y. March 7, 1969), quoted *supra*, pp. 55-56.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals for the Seventh Circuit should be reversed, the order of the District Court should be affirmed, and the action should be remanded to the District Court with directions to award such relief as may appear to be appropriate in further proceedings conducted in conformity with the decision of this Court.

Respectfully submitted,

ARNOLD I. SHURE
11 South La Salle Street
Chicago, Illinois 60603

ROBERT A. SPRECHER
111 West Monroe Street
Chicago, Illinois 60603

EDWARD N. GADSBY
75 Federal Street
Boston, Massachusetts 02110

MOZART G. RATNER
818—18th Street, N. W.
Washington, D. C. 20006
Counsel for Petitioners.

July 14, 1969.